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CONDITION OF AMERICA'S COAL INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY AND MINERAL RESOURCES

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON THE CONDITION OF AMERICA'S COAL INDUSTRY

NOVEMBER 15, 1983

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CONTENTS

STATEMENTS

Page

Altmeyer, Thomas, vice president, Government Affairs, Mining & Reclamation Council of America, Washington, DC 109
Andre, Hon. Frederic, Commissioner, Interstate Commerce Commission, Washington, DC 316
Ford, Hon. Wendell H., a U.S. Senator from the State of Kentucky 22
Gradison, Hon. Heather J., Commissioner, Interstate Commerce Commission, Washington, DC 314
Hertog, John H., senior vice president, Coal and Taconite, Burlington Northern Railroad Co., St. Paul, MN 178
Joseph, Mark R., president, Anker Energy Corp., New York, NY 41
Marshall, Charles N., vice president, marketing, Consolidated Rail Corp., Philadelphia, PA 190
Massey, E. Morgan, president, A.T. Massey Coal Co., Inc., Richmond, VA 38
McKinnon, Arnold B., executive vice president, marketing, Norfolk Southern Corp., Norfolk, VA 123
Moore, C.R., president, Getty Minerals Marketing, Inc., Los Angeles, CA, and president, Western Coal Export Council 98
Ogden, S.O., president, Sunecko Coal Co 79
Rahall, Hon. Nick J., II, a U.S. Representative from the State of West Virginia 9
Rogers, Hon. Harold, a U.S. Representative from the State of Kentucky 23
Snow, John W., senior vice president, corporate affairs, CSX Corp., Richmond, VA 156
Sterrett, Hon. Malcolm M.B., Vice Chairman, Interstate Commerce Commission, Washington, DC 316
Taylor, Hon. Reese H., Jr., Chairman, Interstate Commerce Commission, Washington, DC, accompanied by Ron Young, Director, Bureau of Accounts, Robert Maestro, Environmental Section, and Janice Rosenak, Legislative Counsel 203
Warner, Hon. John W., a U.S. Senator from the State of Virginia 1

APPENDIX

Additional material submitted for the record 329

CONDITION OF AMERICA'S COAL INDUSTRY

TUESDAY, NOVEMBER 15, 1983

U.S. Senate,
Subcommittee on Energy and Mineral Resources,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:13 a.m., in room SD-366, Dirksen Office Building, Hon. John W. Warner presiding.

Present: Senators Warner, Hecht, and Ford.

Also present: Roger Sindelar, counsel; and Linda Mason, professional staff member for the minority.

OPENING STATEMENT OF HON. JOHN W. WARNER, A U.S. SENATOR FROM THE STATE OF VIRGINIA

Senator Warner. Good morning. Today the Subcommittee on Energy and Mineral Resources holds an oversight hearing on the condition of America's coal industry, focusing specifically on the impact of railroad rates and the regulatory policies on U.S. coal sales in the domestic and international markets.

In order for America's coal use to be maximized, it must remain competitive in the world energy market. To remain competitive, price increases in the production, transportation and utilization of coal must be kept reasonable.

Over 60 percent of U.S. coal is transported to the market by rail. The average cost of rail transportation of coal comprises over 30 percent, in some cases as much as 70 percent, of the delivered price of coal. This percentage is steadily increasing. Accordingly, the pricing practices of the Nation's rails and regulatory policies established by the Federal agencies exercising oversight responsibilities on the rails impact significantly the competitiveness of American coal.

Recent reports imply that America's coal sales, both internationally and domestically, are being adversely affected by coal freight pricing and regulatory policies. Indications are that not only will the United States be frozen out of the international coal market, but domestically American coal will see competition once again from foreign coal. This is a matter of grave concern to this subcommittee and indeed many of my colleagues.

As one of its five stated goals, the Staggers Act is to provide a regulatory process that balances the needs of carriers, shippers, and the public. It appears that recent ICC actions; namely, the exemption of export coal from regulation, the decision on revenue adequacy, and the proposed coal rate guidelines, may upset the act's goal of balancing the needs of interested parties. It may also ignore Congress' specific mandate to maintain reasonable rates where there is an absence of effective competition; 70,000 American coal miners are out of work as we gather here this morning. The United States is already losing coal export markets. This year's U.S.-European Conference announced that 7 million tons of coal sales had been lost during 1983 because of high rail rates. Recent news articles imply that an additional 630,000 tons of coal sales will be lost to the United States because of alleged rail unwillingness to lower their high rates.

This appears to be a tilted scale, and if so, it cannot be permitted to continue, as it causes the whole of America to suffer.

Testimony will be received today on how the Staggers Act is being implemented. It is hoped that all affected parties in the future will work in the spirit of harmony to maximize the use of American coal. Rail, coal producers, coal miners, and indeed all Americans will share in the benefits of increased coal sales.

It is my hope that there can be a new willingness on the part of all concerned to assure competitiveness of America's coal under the guidelines set forth by the Congress in the Staggers Act. If there is continued disharmony resulting in lost coal sales opportunities to the United States, then this disharmony may force Congress to institute a new form of regulation to resolve this conflict.

I would also want to add that traveling through my State and talking with a number of rail executives, union officials, and indeed railroad men and women, there is tremendous unemployment in the rail systems. Hundreds of thousands of rail cars and engines are idle, so there must be another side of this story. We are going to give adequate opportunity to hear both sides today and see if we can come to some conclusion.

[The prepared statement of Senator Warner follows:]

OPENING STATEMENT
SENATOR JOHN W. WARNER
NOVEMBER 15, 1983
SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
"IMPACT OF RAILROAD RATES AND REGULATORY POLICIES
ON U. S. COAL SALES"

TODAY, THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES HOLDS AN OVERSIGHT HEARING ON THE CONDITION OF AMERICA'S COAL INDUSTRY, FOCUSING SPECIFICALLY ON THE IMPACT OF RAILROAD RATES AND REGULATORY POLICIES ON U.S. COAL SALES IN THE DOMESTIC AND INTERNATIONAL MARKETS.

THE U.S. HAS THE WORLD'S LARGEST, PROVEN, RECOVERABLE COAL RESERVES. ACCORDING TO THE ENERGY INFORMATION ADMINISTRATION, THESE RESERVES TOTALLED APPROXIMATELY 473 BILLION TONS AS OF JANUARY 1980. COAL PRESENTS THE U.S. WITH A GOLDEN OPPORTUNITY TO REDUCE ITS DEPENDENCY ON FOREIGN ENERGY SOURCES. ADDITIONALLY, AMERICAN COAL HAS THE POTENTIAL TO HELP STABILIZE THE ECONOMIES OF THE ENERGY DEPENDENT NATIONS OF THE WORLD BY REDUCING THEIR DEPENDENCE ON RUINOUS FOREIGN OIL.

IN ORDER FOR AMERICA'S COAL USE TO BE MAXIMIZED, IT MUST REMAIN COMPETITIVE IN THE WORLD ENERGY MARKET.

PRICE INCREASES IN THE PRODUCTION, TRANSPORTATION, AND UTILIZATION OF COAL MUST BE KEPT REASONABLE IF AMERICA'S COAL IS TO REMAIN COMPETITIVE IN DOMESTIC AND INTERNATIONAL MARKETS.

OVER 60% OF U.S. COAL IS TRANSPORTED TO MARKET BY RAILROADS.

THE AVERAGE COST OF RAILROAD TRANSPORTATION OF COAL COMPRISES OVER 30 PERCENT, AND IN SOME CASES, AS MUCH AS 70 PERCENT, OF THE DELIVERED PRICE OF COAL. THIS PERCENTAGE IS STEADILY INCREASING. ACCORDINGLY, THE PRICING PRACTICES OF THE NATION'S RAILROADS AND THE REGULATORY POLICIES ESTABLISHED BY THE FEDERAL AGENCIES EXERCISING OVERSIGHT RESPONSIBILITIES ON THE RAILROADS IMPACT SIGNIFICANTLY THE COMPETITIVENESS OF AMERICAN COAL.

RECENT REPORTS IMPLY THAT AMERICA'S COAL SALES, BOTH INTERNATIONALLY AND DOMESTICALLY, ARE BEING ADVERSELY AFFECTED BY COAL FREIGHT PRICING AND REGULATORY POLICIES. INDICATIONS ARE THAT NOT ONLY WILL THE U.S. BE FROZEN OUT OF THE INTERNATIONAL COAL MARKET, BUT, DOMESTICALLY, AMERICAN COAL WILL SEE COMPETITION ONCE AGAIN FROM FOREIGN COAL BEING BURNED BY U.S. DOMESTIC UTILITIES.

THIS IS A MATTER OF GRAVE CONCERN TO THIS SUBCOMMITTEE, WHICH IS FACED WITH A DOMESTIC COAL INDUSTRY IN A SHARP DOWNTURN AND HORRENDOUS LEVELS OF UNEMPLOYMENT THROUGHOUT THE COAL FIELDS.

PRIOR TO 1980, RAILROAD PRICING WAS STRICTLY REGULATED BY THE INTERSTATE COMMERCE COMMISSION. AT THAT TIME, CONGRESS ENACTED THE STAGGERS RAIL ACT, WHICH MOVED THE INDUSTRY TOWARDS DEREGULATION.

(MORE)

In 1980, as a Member of the Commerce Committee, I strongly supported and voted for the Staggers Rail Act of 1980, believing that it:

(1) Eliminated unnecessary and excessive regulation of the railroad industry;
(2) Improved the financial health of the railroads;
(3) Allowed for the use of railroad transportation contracts;
(4) Preserved a reasonable degree of captive shipper protection.

My support for the Staggers Act was given only after a very careful balance was struck in Committee between providing financial health to the railroads and insuring that adequate safeguards were in the Act to protect captive shippers from unreasonable economic harm.

To disregard the balance between railroads and captive shippers would:

*BLUNT AMERICA'S DRIVE TOWARDS ENERGY INDEPENDENCE,

*UNREASONABLY INCREASE THE COST OF AMERICA'S COAL FOR DOMESTIC AND INTERNATIONAL CONSUMPTION DRIVING CONSUMERS AWAY FROM THIS VITAL ALTERNATIVE FUEL,

*PUT ENORMOUS NUMBERS OF COAL MINERS OUT OF WORK, BRINGING ECONOMIC HARDSHIP TO THE COAL PRODUCING REGIONS, AND

*ADVERSELY AFFECT AMERICA'S BALANCE OF PAYMENTS AND INTERNATIONAL TRADE.

IN THE ACT, CONGRESS ESTABLISHED A SPECIFIC RAIL TRANSPORTATION POLICY TO GUIDE THE I.C.C. IN ITS DUTIES TO REGULATE THE RAILROAD INDUSTRY. THE CONFERENCE REPORT ON THE STAGGERS ACT SAYS - AND I QUOTE :

> "THE CONFEREES INTEND THAT THIS POLICY INCLUDES THE ENCOURAGEMENT AND PROMOTION OF THE TRANSPORTATION OF COAL BY RAIL IN ACCORDANCE WITH THE OBJECTIVE OF ENERGY INDEPENDENCE AT RATES WHICH DO NOT EXCEED A REASONABLE MAXIMUM WHERE THERE IS AN ABSENCE OF EFFECTIVE COMPETITION."

AS ONE OF ITS FIVE STATED GOALS, THE STAGGERS ACT IS "TO PROVIDE A REGULATORY PROCESS THAT BALANCES THE NEEDS OF CARRIERS, SHIPPERS, AND THE PUBLIC."

IT APPEARS THAT RECENT I.C.C. ACTIONS - NAMELY THE EXEMPTION OF EXPORT COAL FROM REGULATION, THE DECISION ON REVENUE ADEQUACY, AND THE PROPOSED COAL RATE GUIDELINES - MAY UPSET THE ACT'S GOAL OF BALANCING THE NEEDS OF INTERESTED PARTIES. IT MAY ALSO IGNORE CONGRESS' SPECIFIC MANDATE TO MAINTAIN REASONABLE RATES WHERE THERE IS AN ABSENCE OF EFFECTIVE COMPETITION.

THESE I.C.C. DECISIONS MAY RESULT IN REDUCING THE USE OF COAL, PUTTING MINERS OUT OF WORK, AND INCREASING THE COAL INDUSTRY'S ECONOMIC HARDSHIP - EXACTLY WHAT CONGRESS DID NOT INTEND WHEN IT PASSED THE ACT.

THE ENERGY INFORMATION AGENCY (EIA), IN AN ANALYSIS OF THE I.C.C.'S DEREGULATION OF COAL EXPORT RATES DECISION, FORECASTS THAT U.S. COAL EXPORTS - BECAUSE OF RECENT I.C.C. RATE ACTIONS - WILL DECLINE BY 14.9 MILLION SHORT TONS IN 1985 FROM THAT PREDICATED UNDER RATE REGULATION, 27.2 MILLION SHORT TONS IN 1990 AND 36.6 MILLION SHORT TONS IN 1995.

FINALLY, IN 1995, THE EIA FORECASTS THAT THE I.C.C. EXEMPTION OF COAL EXPORT RATES WILL GENERATE A $463.6 MILLION INCREASE IN REVENUES FOR THE RAILROADS AND A $1,932.2 MILLION LOSS FOR THE COAL INDUSTRY.

THE EIA ASSESSMENT APPEARS TO CONCLUDE THAT THE BALANCE CONGRESS WAS SEEKING IN PASSING THE STAGGERS RAIL ACT WAS DRAMATICALLY TILTED BY THE RECENT I.C.C. DECISION.

Seventy-thousand American coal miners are out of work, and the U.S. is already losing coal export markets. This year's U.S.-European coal conference announced that seven million tons of coal sales had been lost during 1983 because of high railroad rates. Recent news articles imply that an additional 630,000 tons of coal sales will be lost to the U.S. because of railroads' unwillingness to lower their high rates. This tilted scale cannot be permitted to continue, or all of America will suffer.

I would strongly suggest the the I.C.C., based upon the EIA study and the current international market forces at work in the export coal trade, reexamine its decision on the deregulation of export coal rates and give serious consideration to implementing the balance Congress sought in passing the Staggers Act to provide needed protection for captive coal shippers. I urge the I.C.C. to constantly monitor the impact of its decision to deregulate coal export rates. If and when facts warrant, the I.C.C. - as responsible regulators - should expeditiously act to reverse its decision.

Testimony will be received today on how the Staggers Act is being implemented. It is hoped that all affected parties in the future will work in a spirit of harmony to maximize the use of American coal. Railroads, coal producers, and coal miners, and indeed all Amiercans will share in the benefits of increased coal sales.

It is my hope that there can be a new willingnes on the part of all concerned to assure competitiveness of America's coal under the guidelines set forth by the Congress in the Staggers Act. If there is continued disharmony resulting in lost opportunities to the U.S., then this disharmony may force Congress to institute a new form of regulation to resolve this conflict.

Senator WARNER. We are privileged in the Senate this morning to have two distinguished Members of the House of Representatives to be our leadoff witnesses. Congressman Nick Rahall, the chairman of the House Coal Caucus, comes from the Fourth District of West Virginia.

Congressman Harold Rogers comes from the Fifth District of Kentucky. He is chairman of the Coal Export Caucus. My colleague, Senator Ford, will be joining us this morning, but he is anxious for this hearing to get under way, so we will not await his arrival, and we will invite Congressman Rahall to lead off.

STATEMENT OF HON. NICK J. RAHALL II, A U.S. REPRESENTATIVE FROM THE STATE OF WEST VIRGINIA

Mr. RAHALL. Thank you, Mr. Chairman. Let me commend you and this subcommittee for taking the lead in examining these issues that so vitally affect our Nation's coal resources.

Your comments this morning were right on target and I associate myself with those completely. As a representative of an area that is heavily dependent upon both coal and the railroads, I am pleased to be able to appear before your committee this morning during its investigation of how regulatory actions are impacting our railroad transportation of both domestic and international coal movements.

My comments will concern the Interstate Commerce Commission's decision to exempt from regulation export coal traffic and the coal rate guidelines nationwide which in part will allow a 15 percent per year above inflation increase in coal rail rates—that is 15 percent per year above inflation.

As you know, Senator Ford has introduced S. 1082 and I along with my colleague Hal Rogers have sponsored H.R. 2584 in the House of Representatives, identical bills aimed at restoring the intent of Congress that protections from unreasonable railroad pricing practices be maintained for captive coal shippers.

We have all had considerable experience with the ICC and its railroad coal ratemaking escapades, and our expertise and the expertise of this committee will greatly enhance our legislative efforts as we try to correct these decisions.

Allow me first to make a few remarks regarding the current market situation facing our goal industry. These nontransportation related issues will serve to place into context the concerns that I have over the ICC's actions.

At this time, Mr. Chairman, there is a 28 percent level of unemployment among the Nation's coal labor force, as you are well aware. During the first 6 months of this year, coal production in my home State of West Virginia fell by 21.7 percent over 1982 levels. I might add that Virginia faces a similar situation as you can more accurately testify to with production in your State as I understand falling by 20.7 percent during this same time period.

Without a doubt, coal is facing problems of unprecedented proportions and is in its worst slump in decades. Electricity growth in the United States and in the world is falling off leading to less steam coal demand. Coal's metallurgical markets are shrinking as a result of the depressed steel industry. Utility conversions to coal have ground to a halt because of the threat of an acid rain control program, the worldwide oil glut, and increased imports of Canadian power.

It is interesting to note that 2 years ago the United States exported 112.5 million tons of coal. In 1983, the export coal level was forecast to be only 75 million tons, almost 30 percent below 1982 levels. This decline has heavily impacted West Virginia, a State which produces over 40 percent of all U.S. coal exports.

Compounding the situation is the ICC's regulatory pricing actions and not the capacity of railroad coal transportation. Coal is the No. 1 commodity that is carried by the railroads and accounts for over 36 percent of coal freight tonnage and over 20 percent of total railroad revenue. I would like first to address domestic railroad issues and then move on to the export-related items.

The Staggers Rail Act of 1980 gave the railroads a great degree of rate flexibility. However, during the consideration of that legislation Congress recognized that the level of competition necessary for complete deregulation did not exist in the railroad industry. For this reason, jurisdiction over rate reasonableness was left with the ICC under circumstances where market dominance exists. Captive shippers it was felt were given suitable protections against the possibility of monopolistic railroad pricing practices.

There were some hard-fought battles over this point, and in the House the balance between the revenue needs of the railroads on the one hand and those regulatory restraints necessary for coal to remain competitive in the marketplace came in the form of the Staggers-Rahall-Lee-Loeffler amendment. I am sure you will remember the adoption of the Long-Cannon amendment here in the Senate, yet the ICC has ignored this dovetailing of interests and is seeking to implement the Staggers Act not in the manner that the Congress intended but rather in a way which reflects the attitudes of the present members of the Commission.

The ICC's decision will have far-reaching consequences on the ability of the coal industry to supply the Nation and the world with an economical source of energy. At stake are jobs in the coal fields, low-cost electricity, and an improvement in our balance-of-payments posture.

The coal rate guidelines of the ICC are a formula for disaster. According to a study done by the Energy Information Administration, the ICC decision will cause a decline in coal production of 20.9 million tons in 1985 and 53.7 million tons in 1990. Today, on the average, 30 percent of the delivered price of coal to a utility is due to railroad transportation costs. This cost is passed on to the consumer in the form of automatic fuel adjustment clauses.

Let's use an eastern and western utility as examples of how the 15 percent per year above inflation increase allowed under the coal rate guidelines will cause utility rates to skyrocket.

The Potomac Electric Power & Light which pays on the average a rail rate of $12.78 per ton of coal today will pay $51.75 per year in 1992. This translates into an increase of 405 percent in only 9 years.

For Houston Lighting & Power, the 15 percent increase alone in 1997 will amount to more than what that utility now pays to ship coal in from Wyoming.

Since the Staggers Rail Act of 1980, railroad ratemaking has centered around achieving adequate revenues for the carriers. A viable rail system is in the public's best interest, yes, and carriers should be achieving adequate revenues, yes. However, the ICC has implemented an unrealistic definition of revenue adequacy, has subverted the meaning of market dominance, and has ignored other directives of the act aimed at protecting captive coal shippers such as those contained in the Long-Cannon amendment.

As such, with an unrealistic definition of revenue adequacy in use at the ICC, the goals of the Staggers Act are being thwarted. The reasonableness of rates can never be established when a faulty definition of revenue adequacy is being used to justify setting rates on the basis of whatever the traffic will bear. Under current ICC policy, the more captive the traffic, its demand for service will be greater, and rate increases will be seen as being all the more reasonable.

Market dominance, Mr. Chairman, is nothing more than being given the chance to get your foot in the door over at the ICC. A market dominance determination makes no presumption about the reasonableness of a rate. It merely allows the ICC to investigate a challenged rate, yet under the Commission's contested market dominance rules, coal shippers cannot even get the ICC to consider their complaints. The shipper is in effect being denied due process. He cannot even get his foot in the door.

Mr. Chairman, the majority of export coal from my congressional district moves through the ports at Hampton Roads, VA. We have a common interest in the continued vitality of those ports and I know very well and commend your efforts to obtain an authorization for channel dredging there. As such, it is distressing to note that in the first 6 months of this year coal exports through Norfolk have declined by 38.5 percent over the level established during the same period in 1982.

According to the Chairman of the ICC, Mr. Reese Taylor, whom I know and understand is here this morning, and you will be hearing from later today, the Commission's decision to exempt from regulation export coal will lead to a complete loss—I repeat, a complete loss of export coal production in Virginia, Utah, Colorado and New Mexico, and will cause a substantial decline in export coal production in my home State of West Virginia along with Alabama and Oklahoma.

Mr. Chairman, a study conducted by the National Economic Research Associates found that rail rates will increase by 30 percent above the general inflation rate by 1990 under the export coal exemption. This will lead to a decline of coal exports of between 100 to 132 million tons. In addition, this decision removed the commodities clause on export coal movements and this means the railroads can now produce their own coal, transport it in their own hopper cars, and load it at their own port facilities.

What kind of competition can we expect under these circumstances? How can United Coal, Westmoreland, Island Creek, A.T. Massey and others not expect discriminatory if not predatory pricing practices to be levied against them? The railroads hold market power over these shippers with over 95 percent of individual U.S. mines producing export coal being served by just one railroad. Let us not lose sight of the fact that when it comes down to it, there are only three eastern railroads today—Conrail, CSX and Norfolk-Southern, and they move 61 percent of all coal transported by the railroads. Throw in the Burlington Northern in the West and that figure rises to 82.2 percent.

Not only does the Chairman of the ICC oppose this exemption, but also the U.S. Trade Representative and the Departments of State and Commerce.

In conclusion, while the ICC's recent decisions are not the only problem facing the coal industry today, they will in the near future serve to further reduce competitiveness of coal on the domestic and international markets. We in Congress especially should be concerned about the way in which the ICC has chosen to thwart the intent of an otherwise good law.

I would like to ask permission, Mr. Chairman, to have inserted in the record a document which I prepared that discusses in detail where the ICC has strayed from congressional intent and how the Ford-Rahall bills seek to rectify this situation.

Senator **Warner**. Without objection.

Mr. **Rahall**. I would also like to state that all of the coal and electric utility organizations support these bills as do numerous other organizations, as far ranging as the Chemical Manufacturers Association, American Feed Manufacturers Association. The United Transportation Union representing rail labor is not opposed to this legislation and has taken a neutral position on it, and finally, the National Governors Association, the Southern Governors Association, and the U.S. Conference of Mayors have all adopted resolutions which support the goals of these bills.

Mr. Chairman, I thank you for the opportunity to testify this morning, and I know that I have commented on Senator Ford's legislation here in the Senate, and I am glad to see that he is going to be at these hearings also.

[The prepared statement of Mr. Rahall follows:]

Testimony of Rep. Nick J. Rahall, II (D-W.Va.)
Chairman, Congressional Coal Group
before the
Subcommittee on Energy and Mineral Resources
November 15, 1983

Mr. Chairman and Members of the Subcommittee, you are to be commended for your leadership in examining issues which affect our Nation's coal resources.

As a Representative of an area heavily dependent on both coal and the railroads, I am pleased to be able to appear before this distinguished panel during it investigation of how regulatory actions are impacting railroad transportation of both domestic and international coal movements.

Mr. Chairman, my comments this morning concern the Interstate Commerce Commission's decision to exempt from regulation export coal traffic, and its Coal Rate Guidelines-Nationwide, which in part, will allow a 15 percent per year above inflation increase in rail coal rates.

As you may know, Senator Wendell Ford has introduced S. 1082 and I have sponsored H.R. 2584, identical bills aimed at restoring the intent of Congress that protections from unreasonable railroad pricing practices be maintained for captive coal shippers. The Senator has had considerable experience with the ICC and its railroad coal ratemaking escapades, and his expertise greatly enhances this legislative effort.

Allow me first to make a few remarks regarding the current market situation facing the coal industry. These non-transportation related issues will serve to place into context the concerns I have over the ICC's actions.

At this time, there is a 28 percent level of unemployment among the Nation's coal labor force. During the first six months of this year, coal production in West Virginia fell by 21.7 percent over 1982 levels. I might add that Virginia faces a similar situation, with production in that state falling by 20.7 percent during this period.

Without a doubt, coal is facing problems of unprecedented proportions and is in its worst slump in decades. Electricity growth in the U.S. and the world is falling off, leading to less steam coal demand. Coal's metallurgical markets are shrinking as a result of the depressed steel industry. Utility conversions to coal have grounded to a halt because of the threat of an acid rain control program, the worldwide oil glut and increased imports of Canadian power.

It is interesting to note that two years ago, the U.S. exported 112.5 million tons of coal. In 1983, the export coal level is forecasted to be only 75 million tons, almost 30 percent below 1982 levels. This decline has heavily impacted West Virginia, a state which produces over 40 percent of U.S. coal exports.

Compounding this situation is the ICC's regulatory pricing actions--and not the capacity--of railroad coal transportation. Coal is the number one commodity carried by the railroads and accounts for over 36 percent of total freight tonnage and over 20 percent of total railroad revenue.

Mr. Chairman, I would like to first address domestic railroad issues and then move on to export-related items.

The Staggers Rail Act of 1980 gave the railroads a great degree of rate flexibility. However, Congress recognized that the level of competition necessary for complete deregulation did not exist in the railroad industry. For this reason, jurisdiction over rate reasonableness was left with the ICC under circumstances where market dominance exists. Captive shippers, it was felt, were given suitable protections against the possibility of monopolistic railroad pricing practices.

There were some hard-fought battles over this point. In the House, the balance between the revenue needs of the railroads and those regulatory restraints necessary for coal to remain competitive in the marketplace came in the form of the Staggers-Rahall-Lee-Loeffler amendment. I am sure you will remember the adoption of the Long-Cannon amendment here in the Senate.

Yet, the ICC has ignored this dove-tailing of interests and is seeking to implement the Staggers Act not how Congress intended, but rather, in a way which reflects the attitudes of the present members of the Commission.

The ICC's decisions will have far-reaching consequences on the ability of the coal industry to supply the nation and the world with an economical source of energy. At stake, are jobs in the coalfields, low-cost electricity and an improvement in our balance of payments posture.

The Coal Rate Guidelines are a formula for disaster. According to a study done by the Energy Information Administration, this ICC decision will cause a decline in coal production of 20.9 million tons in 1985 and 53.7 million tons in 1990.

Today, on the average, 30% of the delivered price of coal to a utility is due to railroad transportation. This cost is passed on to the consumer in the form of automatic fuel adjustment clauses.

Let's use an eastern and western utility as examples of how the 15 percent per year above inflation increase allowed under the Coal Rate Guidelines will cause utility rates to skyrocket. Potomac Electric Power & Light, which pays on the average a rail rate of $12.78 per ton of coal today, will pay $51.75 per ton in 1992. This translates into an increase of 405 percent in only nine years. For Houston Lighting and Power, the 15 percent increase alone in 1997 will amount to more than what that utility now pays to ship coal in from Wyoming.

Since the Staggers Rail Act of 1980, railroad ratemaking has centered around achieving adequate revenues for the carriers. A viable rail system is in the public's best interest, and carriers should be achieving adequate revenues. However, the ICC has implemented an unrealistic definition of revenue adequacy, has subverted the meaning of market dominance and has ignored other directives of the Act aimed at protecting captive coal shippers such as those contained in the Long-Cannon amendment.

As such, with an unrealistic definition of revenue adequacy in use at the ICC, the goals of the Staggers Act are being thwarted. The reasonableness of rates can never be established when a faulty definition of revenue adequacy is being used to justify setting rates on the basis of whatever the traffic will bear. Under current ICC policy, the more captive the traffic, its demand for service will be greater, and rate increases will be seen as being all the more reasonable.

Market dominance, Mr. Chairman, is nothing more than being given the chance to get your foot in the door over at the ICC. A market dominance determination makes no presumption about the reasonableness of a rate. It merely allows the ICC to investigate a challenged rate.

Yet, under the Commission's contested market dominance rules, coal shippers cannot even get the ICC to consider their complaints. The shipper is, in effect, being denied due process.

Mr. Chairman, the majority of export coal from my Congressional District moves through the ports at Hampton Roads, Virginia. We have a common interest in the continued vitality of those ports and I well know of, and commend, your efforts to obtain an authorization for channel dredging there. As such, it is distressing to note that in the first six months of this year coal exports through Norfolk have declined by 38.5 percent over the level established during the same period in 1982.

According to the Chairman of the ICC, Reese Taylor, the Commission's decision to exempt from regulation export coal will lead to a complete loss--I repeat, a complete loss--of export coal production in Virginia, Utah, Colorado and New Mexico and will cause a substantial decline in export coal production in my state of West Virginia, along with Alabama and Oklahoma.

A study conducted by the National Economic Research Associates found that rail rates will increase by 30 percent above the general inflation rate by 1990 under the export coal exemption. This will lead to a decline of coal exports of between 100 to 132 million tons.

In addition, this decision removed the commodities clause on export coal movements. This means that the railroads can now produce their own coal, transport it in their own hopper cars and load it at their own port facilities.

What kind of competition can we expect under these circumstances. How can United Coal, Westmoreland, Island Creek, A.T. Massey and the others not expect discriminatory, if not predatory, pricing practices to be levied against them. The railroads hold market power over these shippers, with over 95 percent of individual U.S. mines producing export coal being served by just one railroad.

Let us not lose sight of the fact that when it comes down to it, there are only three eastern railroads today: Conrail, CSX and Norfolk-Southern, and they move 61 percent of all coal transported by the railroads. Throw in the Burlington Northern in the West and that figure rises to 82.2 percent.

Not only does the ICC Chairman oppose this exemption, but also the U.S. Trade Representative and the Departments of State and Commerce.

In conclusion, while the ICC's recent decisions are not the only problem facing the coal industry, they will in the near future serve to further reduce the competitiveness of coal on the domestic and international markets. We in Congress especially, should be concerned with the way in which the ICC has chosen to thwart the intent of an otherwise good law.

At this point, I would like to ask permission to have inserted into the record a document I have prepared which discusses in detail where the ICC has strayed from Congressional intent and how the Ford/Rahall bills seek to rectify this situation.

I would also like to state that all of the coal and electric utility organizations support these bills, as do numerous other organizations as far-ranging as the Chemical Manufactuers Association to the American Feed Manufactuers Association. The United Transportation Union, representing rail labor, is not opposed to the legislation and has taken a neutral position on it. And finally, the National Governors Association, the Southern Governors Association and the U.S. Conference of Mayors have all adopted resolutions which support the goals of the bills.

Mr. Chairman, I will be pleased to respond to any questions you may have.

ICC Decisions Affecting Railroad Transportation Of Coal: Congressional Intent Versus ICC Interpretation And Solutions Offered By H.R. 2584 and S. 1082

Office of Rep. Nick J. Rahall

Rate Reasonableness

Citing the Rail Transportation Policy, the ICC's basic philosophy in the Coal Rate Guidelines is that railroads, pursuant to section 10101a(1), should be permitted to set rates on captive traffic on the basis of demand for services. This means that a carrier can charge whatever the traffic will bear.

The Commission has focused only on this provision of the policy and has seized those words as justification for allowing rates to increase to whatever the traffic will bear. As such, the more captive the traffic is, the greater the demand for service is and the more reasonable rate increases become.

However, section 10101a(6) states that reasonable rates must be maintained where there is an absence of effective competition. The Conference Report on the Rail Transportation Policy section of the Staggers Rail Act of 1980 stated: "The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objectives of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition." Obviously, the ICC is not giving equal weight to all provisions of the policy and is engaging in selective cnsideration of those provisions which suit its own particular philosophy.

H.R. 2584 clarifies section 10101a(1) by deleting the words "demand for services" and inserting "competition among carriers to provide transportation services." The bill stresses that rates on captive traffic must be maintained a reasonable levels where there is an absence of effective competition.

In the Coal Rate Guidelines, the ICC treats revenue adequacy as the sole consideration in determining rate reasonableness. The

Staggers Rail Act of 1980 said the ICC should consider adequate revenues in determining rate reasonableness. However, the Act also said, and the Conference Report asserted, that three other reasonableness factors contained in the Long-Cannon amendment must be considered.

H.R. 2584 address this situation in three ways. First, it imposes the burden of proof on the carrier to establish the reasonableness of any rate where the rate exceeds 190% of variable costs and the ICC refuses to investigate. Secondly, the carrier would have the burden of going forward with evidence responsive to certain Long-Cannon factors. Thirdly, revenue adequacy considerations are explicitly tied to the Long-Cannon factors which concern the relationship of a rate to the carrier's fixed cost contribution sought from the traffic and the effect of the rate on national energy goals.

(It should be noted that in its Coal Rate Guidelines, the ICC decided that a 15% per year above inflation increase in coal rates is reasonable for revenue inadequate carriers. Such increases are not subject to challenge. The Staggers Rail Act of 1980 does not support this 15% figure. The Act provides for inflation adjustments and a rate flexibility zone allowing for 6% of the adjusted base rate in the first four years after enactment--limited to an 18% increase over this period--and 4% thereafter for inadequate revenue carriers.)

Revenue Adequacy

The Staggers Rail Act of 1980 told the ICC that it had the authority to revise its revenue adequacy standards and procedures as necessary. In 1978, the Commision adopted standards which called for the consideration of rate of return equal to the cost of capital, funds flow analysis and several financial ratios in determining revenue adequacy. In 1980, using these standards, it was found that 11 out of 31 Class I railroads were revenue adequate.

After enactment of the Act, however, the Commission established as the sole measure of revenue adequacy a rate of return on investment equal to the current cost of capital. Under this measurement, not a single Class I railroad was found to be revenue adequate.

Congressional intent is sparse and at times, inconsistent, on this matter. In explaining the Conference bill on the House floor, Representative Edward Madigan said that "a rate of return adequate to attract capital is the only economically rational revenue adequacy standard." Yet, he went on to say that the "conferees do not intend to preclude the use of any sound economic tools which will assist the Commission to make their determination." And in the Senate, Senator Russell Long stated that "the bill does not require the ICC to develop new standards for determining revenue adequacy. It only requires the ICC to conclude such a proceeding which it started some time ago." This statement would favorably indicate the inclusion of financial ratios.

H.R. 2584 would require the ICC to consider widely used indicators of financial health in addition to return on investment.

Market Dominance

The "4R" Act defined market dominance as "an absence of effective competition from other carriers or modes of transportation for the transportation which a rate applies." The Staggers Act retained this definition.

At the time the Act was enacted, the ICC used two presumptions of market domiance: whether there was substantial shipper investment in railroad plant and the market share test which consisted over whether 70% or more of commodity was shipped by a carrier in the previous 12 months. In addition product and geographic competition were not considered.

After passage of the 1980 Act, the ICC eliminated the market share and substantial shipper investment presumptions and promulgated a market domiance determination which included product and geographic competition.

The Conference Report on the Staggers Rail Act of 1980 clearly stated that "it is not intended that there be any change in the meaning of the term, nor is any change intended in the Commission's authority to determine market dominance and reasonableness concurrently."

This statement, and the fact that the definition of market dominance remained unchanged, does not lend support to the Commission's inclusion of product and geographic competition.

H.R. 2584 would codify the previous market dominance presumptions and make it clear that product and geographic compection are not appropriate considerations.

Exemptions--Export Coal

In exempting export coal traffic from regulation, the ICC based its decision on section 10505. The Commission pursuant to this section said that continued regulation of export coal is not necessary to carry out the transportation policy of the Act and that the exemption would not constitute an abuse of market power. In its explanation of the exemption, the ICC said that its decision is based to a great extent on world (geographic) competition in the international coal market. In addition, the ICC said the exemption was limited in scope.

Since geographic competition would not appear to be an appropriate consideration of market power, world competition in the international coal market is an invalid premise for granting the exemption. Also, since the ICC's own analysis shows that over 95% of individual U.S. mines producing export coal are served by just one railroad, obviously, the carriers have market power. Furthermore, considering the amount of coal exported in both dollars and tons and the number of railroads and ports involved, the exemption is not limited in scope. Finally, the transportation policy states that reasonable rates must be maintained in the absence of effective competition and that predatory pricing is prohibited.

It should be noted that the exemption removed the commodities clause limitation. As such, a railroad could produce its own coal, transport it on its own railroad cars and ship it through its own port facilities. Nothing would stop a carrier from engaging in predatory pricing practices against other coal producers.

H.R. 2584, in clarifying the exemption criteria, would prohibit the ICC from exempting market dominant traffic from regulation.

Senator WARNER. We thank you, Mr. Rahall. You mentioned Mr. Staggers. I was privileged to know him. I thought it might have been advisable to have him here as a witness today and perhaps before the record is closed we will provide him an opportunity.

I should also like to note that our distinguished Minority Leader Robert C. Byrd is without a doubt one of the most concerned individuals about this subject also. He is very active, as you well know, in our coal efforts.

At this time, however, I do turn to my distinguished colleague, Mr. Ford from Kentucky for any comments he might wish to make.

STATEMENT OF HON. WENDELL H. FORD, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator FORD. I thank the Chairman.

I might compliment Congressman Rahall and Congressman Rogers for their efforts, and I want to make an unusual statement. The gray-headed fellow out there, I ran for office about five times now and he has never been for me, but he is one of the best Congressmen the fifth district ever had. I want you to reciprocate!

He represents his people well, and we work together in a splendid fashion, and I compliment both of the Congressmen for their diligence and efforts in this field, and I compliment the Chairman in his efforts, too. I think we are on the right track and we need to find some answers, and those answers can be before the action instead of after it. I think we will proceed in the right, proper manner, Mr. Chairman.

I thank you for the opportunity, and I do appreciate these two fine gentlemen being here to testify today.

Senator WARNER. Thank you, Mr. Chairman. Before we return to the distinguished Member from Kentucky's congressional delegation, would you have any observations on my closing point in the opening statement, namely, the thousands upon thousands of idle rail employees and railcars and locomotives and the like?

Mr. RAHALL. Well, I would comment that with today's slump in the coal markets, as I have pointed out in my testimony, for the reasons that I pointed out, coal production is certainly down. Therefore, those cars are sitting idle and workers perhaps are being laid off in the rail industry.

As far as the fact that the railroads will contend that they have not raised their rates as much as they are allowed to do under these ICC decisions in today's markets that is perhaps true, but the potential is there in the future for when coal picks up, and I am as bullish on coal as anybody, and when those markets improve, that the potential is there for rail rates to increase dramatically higher than they are today, thus negating any positive effect that we may experience from a coal boom in the future. I am concerned that this potential exists in the future for exorbitantly higher rail rates than what we are experiencing today.

Senator WARNER. Well, I just raise the point. If the rail systems were 100 percent utilized, then you might have a stronger case for the indictment that they are just ignoring coal and going to higher profitability cargos. With the idleness of so much of the system, I am having difficults believing rails are ignoring coal and pricing it out of the market thus reducing their traffic more. Perhaps other witnesses can lend some light on the answer.

Well, our distinguished colleague from Kentucky, you will be given equal time to rebut Mr. Ford's opening comments.

STATEMENT OF HON. HAROLD ROGERS, A U.S. REPRESENTATIVE FROM THE STATE OF KENTUCKY

Mr. **Rogers**. Thank you very much, Senator. Mr. Chairman, members of your distinguished panel, I appreciate the opportunity to testify before your subcommittee today, and considering the dire straits the coal operators are in, I commend the chairman for not only holding these hearings, but this continuing series that is going on.

To my distinguished senior colleague from Kentucky who sits on this panel who has been in fact a never-tiring advocate of the coal industry in not only Kentucky but the Nation, I want to compliment him on the bill that he has filed and in support of which we testify here today.

Before I came to Congress and started trying to keep up with Senator Ford on helping the coal industry I was dark headed, rested, and unworried. Since coming here only 2½ years ago, you can see what has happened to me in that time just trying to keep up with Senator Ford.

It is true that we sit across the political aisles from each other, but I must say today that he has been that untiring servant of our people in relation to the coal problems that we all face. I am glad to see you here this morning.

Senator **Warner**. I would like to observe that in my brief tenure on this committee there is no member that puts in longer hours with more incisive questioning in preparation for witnesses than Mr. Ford.

Senator **Ford**. May I ask a question? Are you sure you got all that down?

Mr. **Rogers**. I realize, Mr. Chairman, that you have a long list of witnesses today so with the permission of the chairman, I would like to submit my written testimony for the record and highlight a few points of particular importance I think because transportation is so vital to coal.

I would like to focus on three main subjects—one, the ICC's implementation of the Staggers Act; two, the impact of this policy on our national interest; and three, the particular effects of this policy on smaller coal operators.

My distinguished colleague from West Virginia has already mentioned some glaring examples of the ICC's cavalier approach toward the law. I would like to reiterate that the ICC through a wide range of administrative actions has blatantly disregarded congressional intent in its implementation of the Staggers Act. From their definition of, quote, "revenue adequacy," to their changes in railroad accounting practices, the ICC has repeatedly taken actions which at least on paper make the railroads' revenue adequacy appear poorer, make their expenses appear higher, and their variable costs higher still. I am concerned that these actions have had the effect of making it easier for the railroads to escape the intended ICC control and charge higher rates for their coal traffic.

The blatancy of the flaws in the implementation of the act are nothing short, Mr. Chairman, of outrageous. For example, there is the question of stipulating which expenses and revenues should be considered in the return on investment calculation, an area where the ICC allows the railroads considerable flexibility.

I was outraged to learn, for example, that if a railroad owns a fuel oil company which supplies all of its diesel fuel, the cost of the fuel is listed as an expense in the ROI calculation, but on the other side of the ledger, not a penny of the revenues of the fuel oil company are considered. This clearly gives one the impression that the flow of funds is accounted for on the one-way, outward flowing basis which all serves to reduce the return on investment figure and which in turn is used to testify to approval of higher rail rates.

One other flaw I would like to point out to the subcommittee is the fact that the cost of recovery index used by the ICC to adjust rail rates for captive traffic can only go up. Because of the way the ICC has administered this index, when the index goes up, railroads can raise their rates, but when the index reflecting rail costs falls, the rates don't have to budget from those higher levels. What this means is that when demand for coal falls as we have had in recent months, the coal operators and not the railroads are all too often the ones who are forced to slice off their margins of profit at lower prices.

In addition, and perhaps most importantly, I am especially concerned about the coal rate guidelines which blatantly disregard the instructions laid down by the Congress in the Staggers Act by the export exemption decision which ignored the congressional directives on the granting of limited exemption. These administrative actions all boil down to several painful facts. If they are allowed to stand, American consumers will face higher bills in their electric rates and less American coal will be burned at home and abroad.

Recently the National Economic Research Associates undertook a study on the effects of further rail rate deregulation. They estimated that rail rates for coal would be 30 to 60 percent higher under deregulation than under continued regulation. In 1981, our utilities paid $5 billion to move their coal on the railroads—$5 billion. As a result of ICC actions, they expect these costs to double in 5 years, triple in 8 years, and quadruple within 10 years, and of course, it is our residential and industrial consumers who will pay for that policy, and it gets even worse. With transportation costs already accounting for 30 percent of the delivered price of coal, we could expect to see more of our domestic utilities following the lead of some eastern and southern utilities which have begun purchasing foreign coal to stock their boilers since it so so much cheaper than our American delivered coal, even if we have to haul the foreign coal across the entire ocean first to get it there. We might also expect to see some of our domestic energy companies marketing their South American coal here as well.

The effect of this deregulation would also have a devastating effect on our international markets. The export coal market is today the most promising, lucrative market on American coal's horizon. It has the potential to lead to billions of dollars in business and tens of thousands of coal and transportation jobs here at home. But this increased trade isn't ours just for the asking, of course. Everywhere we have gone to promote American coal in Japan, Korea, Hong Kong, Taiwan, Europe, the message is the same from these countries. Producers around the world can already undersell us and unless we can substantially reduce our transportation costs, we have little hope of securing more than a marginal role in the foreign coal trade.

The export exemption by the ICC is the worst possible decision that could have been made. Our own negotiators have just returned from Asia where they are trying to convince our buyers to sign contracts with the United States and to make us more than swing spot-sale suppliers, but the decision made by the ICC will reinforce the preception that American sales are expensive, will erode our positive selling point—the stability of our coal delivery system—and will force us into that continued role as the provider of coal at the last resort.

This is a small and to me unacceptable role within a potentially lucrative coal export market, and incidentally, our own Department of Energy has corroborated these fears. They estimate as a result of the coal rate guidelines U.S. coal exports will decline by 14.9 million tons by 1985, by 17.1 million tons in 1990, and by 36.6 million tons by 1995 as compared with estimates based on current regulations.

The immediate effect would be not only a worsening balance of trade payments, but an even more serious result would be lost jobs. With 65,000 to 70,000 miners already unemployed here, I frankly don't believe we can afford to toss away the opportunity for tens of thousands of new coal jobs.

Mr. Chairman, the question is not one of whether the railroads can afford continued regulation. The question is whether our unemployed coal miners can afford this lost employment potential.

In exchange for higher rail revenues, the ICC gives us little in return. They give us higher utility bills and a worsening balance of payments. They give us lost jobs in our coal fields, and eventually lost jobs in our railroads, as the Chairman has indicated, as well as at our ports as coal sales dwindle.

And finally, Mr. Chairman, I would like to comment on the particular effects of the ICC's implementation of the Staggers Act on the smaller coal operators.

The act has had several effects for all coal operators, both large and small, but since I represent one of the last strongholds of small coal operators, I have seen their unique difficulties first hand and would like to comment on them here today.

Time after time my coal operators tell me of the trouble they have had selling their coal. Nearly all of them are served by just one rail line and neither trucking nor water transportation offer feasible alternatives. If one railroad offers them a rate that they don't like, or if it makes their coal noncompetitive, they have no choice but to accept the rate or not sell their coal.

Also, I have talked to some of the utilities my operators try to sell their coal to. They tell me how difficult it is to do business with operators in my area who are served by just one rail line when that line doesn't offer competitive rates.

The point is clear. These small operators have too little market strength to protect themselves from possibly abusive market practices, and minus the effective ICC regulation which the Congress had intended to retain in order to protect them, they will be left permanently in the vicious cycle where they are too small to lock into low transportation rates, and where their high transportation rates lock them out of the coal sales.

I would like to leave the subcommittee with one final fact. Between 1977 and 1980, the number of small coal mines in the United States decreased by almost two-thirds. During this same period, their share of U.S. production fell by one-half, while total coal production rose by 18 percent.

The picture before us, Mr. Chairman, is of the swift demise of the small coal operator. This scenario is bad for coal communities throughout the Eastern part of the United States where it means unemployment, lost business, economic stagnation, but it also is bad for our consumers since smaller coal operators have traditionally offered needed competition to keep domestic coal prices down.

The Staggers Act offered a carefully balanced answer by providing minimal regulation but still enough regulation to offer our captive shippers, large and small alike, the protection they needed to survive. Without any congressional approval, the ICC has effectively erased this careful balance from the books, and with their action they have erased jobs and business for coal communities throughout the United States.

For this reason, I urge your support and prompt action on the bill offered by our colleague from Kentucky, Senator Ford. Whatever legislative steps this subcommittee may take, I urge you to take special care to protect our smaller operators who are a vital part of America's energy mix.

[The prepared statement of Mr. Rogers follows:]

STATEMENT

THE HONORABLE HAL ROGERS

before the

SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

of the

COMMITTEE ON ENERGY AND NATURAL RESOURCES

November 15, 1983

Mr. Chairman, I appreciate the opportunity to testify before this subcommittee today. And considering the dire straits of the American coal industry, I commend the chairman for his foresight in conducting this important hearing.

Because transportation is so vital to coal, I would like to focus my comments on three main subjects: first, the Interstate Commerce Commission's implementation of the Staggers Act, which I would characterize as blatantly ignoring congressional intent; second, the impact of their policy on the American public and on American national interest; and finally, it's often unrecognized impact on the smaller coal producers which are so prevalent in the Appalachian region of our country.

INTERSTATE COMMERCE COMMISSION POLICY:

The ICC has taken a variety of actions through administrative procedures which have had the effect of dramatically shifting the impact of the Staggers Act. I would like to highlight a few of these actions for the subcommittee.

1) Revenue Adequacy:

The concept of revenue adequacy was first used in rail rate making policy in the course of the 4-R Act in 1976. At that time, Congress defined revenue adequacy as a level of earnings which was sufficient to allow a carrier to meet all of its expenses, retire a reasonable amount of debt, cover plant depreciation, and to earn a sufficient return on investment in order to allow it to attract new capital.

The definition was reiterated in the Staggers Act. But at that time the term took on added significance since it established the policy that a finding of revenue inadequacy would entitle a carrier to increased rate flexibility.

Since that time, however, the ICC has taken administrative actions to substantially redefine revenue adequacy. Under this new definition in Ex Parte No. 393, the ICC would look only at the single factor of return on investment rather than at the broad range of variables they had considered before in establishing a finding of revenue inadequacy. And under this new definition, which represents such a marked departure from the Congressional definitions, the ICC found that all but THREE of our nation's Class I railroads were revenue inadequate. And by this year, the number of revenue adequate railroads had dropped to ZERO under the ICC's new definition.

And this is despite the fact that many of our railroads are showing record profits and some have even started corporate acquisitions to dispose of excess cash.

It is my contention that the ICC's administrative actions in the area of revenue adequacy defnitions represent a gross departure from congressional intent.

2) Coal Rate Guidelines:

One of the unmistakable goals of Congress in the Staggers Act was to provide some measure of protection for captive shippers, and particularly to ensure that one set of captive shippers, or one commodity, would not be forced to subsidize the cost of another's transportation.

Moreover, the Congress set specific rate guidelines in the legislation, creating a statutory zone of flexibility in which a carrier could raise its rates by 6% per year, plus an amount accounting for inflation until September 30, 1984. After that time, the zone of freedom provision would only apply to revenue inadequate railroads, and then they would only be allowed a 4% increase plus inflation.

But despite these clear instructions in the statute, the ICC decided in Ex Parte No. 347 (Sub-No. 1) in its Coal Rate Guidelines that it would permit rate increases of up to 15% per year after inflation!

And I would like to point out for the record that under this program, the entire perceived rail industry revenue shortfall could be paid for by coal traffic alone!

Clearly, the ICC is ignoring Congressional intent both in terms of cross subsidization and in terms of the actual zone of freedom from ICC regulation.

3) Railroad Accounting Practices and Cost Reporting:

As I am sure the Committee is aware, railroad earnings and profits have traditionally been calculated with the "retirement-replacement betterment" accounting method. This is a method used only by the railroads. And in 1981, GAO reported to the Congress that changes were needed in this accounting method since it led to an overstatement of expenses and an understatement of net income. Obviously, this would affect the all-important determination of revenue adequacy for a carrier, and was one of the concerns raised by Congress in the Staggers Act.

Since then, the ICC has proposed requiring the railroads to switch to depreciation accounting, which is the method used by most U.S. industries. While this would represent some improvement in accounting practices, at the same time the ICC has proposed to "write up" all of the railroads' assets to the current replacement cost, a practice which would mitigate much of this improvement and which it is interesting to note, no other federal agency accepts.

Moreover, the ICC has taken significant steps in the methodology for calculating variable costs.

As the members of this subcommittee are aware. one of the key thresholds in the Staggers Act is the ratio of rate revenues to variable costs. Below a set level, the ICC would have no jurisdiction to review the rates.

At the time the Congress considered the Staggers Act and set these threshold levels, the ICC determined railroad costs by using a tool known as "Rail Form A." Since then, the Commission has proposed changing to a new method, known as the Uniform Rail Costing System. Under the ICC proposal, URCS would assign a high percentage of the carriers' costs to the variable cost category.

The result of this seemingly innocuous change: revenue to variable cost ratios would appear lower and fewer rates would be subject to ICC review--even though many of these rates would have been eligible for review using Rail Form A, the method used at the time the Staggers Act was passed.

The blatancy of the flaws in the implementation of the Act clearly are nothing short of outrageous. For example, there is the question of stipulating which expenses and revenues should be considered in the Return on Investment (ROI) calculation--an area where the ICC allows the railroads considerable flexibility.

I was outraged to learn, for example, that if a railroad owns a fuel oil company which supplies all of its diesel fuel, the cost of the fuel is listed as an expense in the ROI calculation. But on the other side of the ledger, not a penny of the revenues of the fuel oil company are considered.

This clearly gives the indication that the flow of funds is accounted for on a one-way (outward flowing) basis--which serves to reduce the ROI figure and which in turn is used to justify approval of higher rail rates.

One other flaw I'd like to point out to the subcommittee at this time is the fact that the Cost of Recovery Index used by the ICC to adjust rail rates for captive traffic can only go up. Because of the manner in which this index was established, when the index goes up, railroads can raise their rates. But when the index, reflecting rail costs, falls, the rates don't have to budge from their high levels.

What this means is that when demand for coal falls, all too often it is solely the coal operators and not the railroads who are forced to slice off their margins of profit in lower prices.

4) Exemption:

On June 12, 1983, the ICC announced its decision to remove all aspects of export coal movement from ICC regulation. This far-reaching action eliminated all ICC jurisdiction over pricing, common carrier obligations and non-discriminatory practice questions relating to the transportation of coal exports.

The Staggers Act had given the ICC the authority to grant exemptions in certain cases. But the statute specifically limits exemptions to instances where regulation is "not needed to protect shippers from the abuses of market power."

Considering that approximately 90% of our nation's coal shippers are served by only one rail carrier, that inland waterways offer no direct service from our coal fields to the eastern ports, and that trucking costs are prohibitive for long hauls, ICC coments to the contrary notwithstanding, it is clear that a huge portion of our coal shippers are captive and enjoy little protection from possible abuses of market power. As Chairman of the Interstate Commerce Commission Reece Taylor stated in a press release following the ICC decision, "The almost complete lack of domestic competition means that the railroads will be able to price and provide service discriminatorily. In fact, the railroads have stated that they will price their services, not on the basis of their cost of service, but on the basis of each mine's long term marginal costs."

Clearly, this far-reaching exemption goes well beyond the Congressional intent in allowing exemptions only in cases where there would be protection against abusive market power.

IMPLICATIONS FOR PUBLIC WELFARE AND NATIONAL POLICY:

What all of these decisions and administrative actions boil down to is painfully clear: if they are allowed to stand, American consumers will face higher bills and less American coal will be burnt, both at home and abroad.

Recently, the National Economic Research Associates, Inc. (NERA) undertook a study on the effects of further deregulation of rail rates. They estimate that rail rates for coal would be 30-60% higher under deregulation than under continued regulation.

In 1981, our utilities paid $5 billion to move their coal on the railroads. As a result of the ICC actions, they expect these costs to double in five years, triple in eight years, and to quadruple within ten years. And of course, it is our residential and industrial consumers who will pay for this policy.

These higher utility costs translate directly into higher bills for residential and industrial consumers. Edison Electric Institute estimates that under the ICC's 15% Rule, the federal government's utility bill would increase by $3 million in the first year. In Michigan, the auto and steel industry would face an increase of $8 million in the first year. And again, EEI points out that this figure would double in five years and quadruple in 10 years.

In view of the many difficulties American industries are already facing, it hardly seems wise to tack on a "utility tax" for our recovering industries through the form of uncontrolled deregulation.

And of course, with transportation costs already accounting for 30% of the delivered price of coal to our utilities, we would expect to see some dramatic shifts in our utilities' coal consumption patters. We already have several eastern and southern utilities which have begun purchasing foreign coal to stoke their boilers since it is often cheaper to than our American coal--even if we have to haul it across an entire ocean first. And we might expect to see some of our domestic energy companies marketing their South American coal here as well.

But the implications are not limited to domestic consumption patterns. We could expect to see far-reaching changes in the international market and in America's role in the international market as well.

In 1981, coal exports from the U.S. totalled $5.4 billion. The industry projects substantial growth in the international coal market as foreign countries continue their policies to convert off of unstable oil supplies and onto coal--with some estimates that American coal sales could even triple by the end of the century. The export coal market is the most promising, lucrative market on American coal's horizon. It has the potential to lead to billions of dollars in business and tens of thousands of coal and transportation jobs.

But this increased trade isn't ours just for the asking. The international market is extremely competitive--and producers all across the globe can already undersell us. And everywhere I've gone to promote American coal--in Japan, Korea, Hong Kong, Taiwan and Europe as well--the message is the same. The major international buyers have told me personally that unless America is able to reduce its transportation costs, we have little hope of securing more than a marginal role in this coal trade.

The Export Exemption decision by the ICC is the worst possible decision that could have been made in terms of our coal exports. Our own negotiators have just returned from Asia where they have been trying to convince our buyers to sign contracts with American producers and to make us more than swing, spot-sale suppliers. But the decision made by the ICC will reinforce the perception that American sales are expensive, will erode our one positive selling point (that our coal delivery system is stable) and will force us into that continued role as the provider of last resort. This is a terribly small--and to me, unacceptable--role within a potentially lucrative coal export market.

And I would like to report to the subcommittee that these fears have been corroborated by our own government agencies, including the Department of Commerce and the Department of Energy. The Energy Information Administration wrote in their document "Railroad Deregulation: Impact on Coal" published in May, 1983, that deregulation would have a severe impact on our coal exports. Citing the ICC estimates indicating that rail rates would increase under their proposals by 29% in 1985, by 71% in by 1990, and by 90% by 1995, they project that US coal exports will decline by 14.9 million short tons in 1985, 27.2 million short tons in 1990, and by 36.6 million short tons by 1995 as compared with estimates based on the continuation of current regulations.

The immediate effect would be a worsening balance of payments. But an even more serious result would be lost jobs. With 65,000 coal miners already unemployed, I frankly don't believe we can afford to toss away the opportunity for tens of thousands of new coal jobs. And with our coal operators watching their idle equipment gather rust now that our coal industry is operating at only about 65% of capacity the problem becomes even more serious.

The United States has made repeated commitments to our allies and major trading partners to reduce our dependence on foreign oil and to work towards increased utilization of other energy sources such as coal, in such agreements as the Tokyo Economic Summit of 1979 and the 1980 Vencie Summit. By raising world-wide coal prices, the EIA further estimates that one side effect of the ICC actions would be the reduced worldwide consuption of coal. Such actions would seriously undermine the credibility of US negotiators when we next approach the bargaining tables with our trading partners.

So in exchange for higher rail revenues, the ICC actions give us little in return. They will leave us with higher utility bills. They will leave us with a worsened balance of payments. They will leave us with deteriorating credibility with our trading partners. And they will leave us with lost jobs--at first, just in our coal fields, but then gradually also on our railroads once the higher coal prices translate into fewer coal sales and smaller shipments of American coal.

The bottom line of all that fine print in the Federal Register actually amounts to an ICC commitment to trade away this outstanding business and jobs potential to our far more prudent competitors overseas.

IMPACT ON SMALL AND MEDIUM SIZED COAL COMPANIES:

Finally, I would like to comment on the particular effect of the Staggers Act and its implementtion on the smaller coal operator. Of course, the effect has been severe for all coal operators, large and small. But representing one of the last strongholds of the small coal operator in the United States, I would like to discuss the particularly severe impact which the Act has had on them.

The ability of a party to a contract to protect itself from abuse of market power depends on the relative market strength of the parties. Large shippers whose facilities are served by more than one railroad and shippers who have practical access to another competitive mode would have enough market power to negotiate a fair rail service contract in many cases. But smaller shippers, concentrated in the Eastern Appalachian coalfields, are often captive to one carrier for at least a segment of their transportation and because of the small size of their shipments, do not have any economic strength in bargaining rates. Shippers, like these coal operators in my district, who have no reasonable alternative but to take the contract terms imposed on them by railroads have no protection from possible abuses of market power.

Without regulation, the carriers possess all the bargaining power and have unconstrained ability to dictate transportation costs to the shipper. The result is a terribly vicious cycle. The small operator doesn't command enough bargaining power to lock in reasonable rail rates, so he isn't able to compete in the marketplace--and because he can't compete, he is unable to garner the coal contracts necessary to give him additional bargaining strength with the railroads.

And Mr. Chairman, I hear the results over and over when I talk with the coal operators in my district. Time after time, my coal operators tell me of the trouble they have selling their coal. Nearly all of them are served by just one rail line and neither trucking nor water transportation offer feasible alternatives. That one railroad offers them a rate. If they don't like the rate, or if it makes their offer for a coal sale uncompetitive, they are left with just two choices: they can either not sell their coal or they can reduce their profits to the bare bone. And Mr. Chairman, the coal operators in my district have done a lot of both these options.

I'd like to leave the subcommittee with one final fact. Between 1977 and 1980, the number of small coal mines in the US decreased by over 60%. During this same period, their share of US production fell by 50%, while total coal production rose by 18%.

The picture before us, Mr. Chairman, is of the swift demise of the small coal operator in many cases.

This scenario is bad for coal communities throughout the eastern part of the US where it means unemployment, lost business and economic stagnation. But it is also bad for our consumers, since smaller coal operators have traditionally offered needed competition to keep domestic coal prices low.

The implementation of the Staggers Act has had serious effects for the entire coal industry--but it has had its worst effect on the smaller operator who is faced with a monopolistic carrier in many cases and who has had increasingly little regulatory oversight from the ICC.

The Staggers Act offered a carefully balanced answer to provide minimal regulation-but still sufficient regulation to offer our captive shippers--large and small alike--the protection they needed to survive. But without any congressional approval, the ICC has effectively erased this careful balance from the books. And with it, they have erased jobs and business for many coal communities throughout the U.S.

CONCLUSION:

The Staggers Act, as written by the Congress, was a carefully crafted document--intended to give the railroads an adequate return on their operations while still providing captive shippers with adequate protection against abusive market power.

We have made great progress towards the first goal, with marked improvements in the railroads' equipment, service and financial well-being. As the annual reports from many of our nation's railroads illustrate, they are enjoying tremendous improvements in their profitability and in their ability to attract capital. This improvement had long been needed and I am pleased to see it. And coal operators in my district have been quick to point out the greatly improved service they have received.

Nevertheless, I am deeply concerned that we are in danger of neglecting our second goal, that of providing captive shippers with some degree or protection. Time after time, the ICC has re-written congressional intent through their administrative actions, and the victim has been the American public, the American coal industry, the American balance of payments, and American jobs in the coal fields, the ports, and soon on our railroads themselves.

For this reason, I urge the prompt passage of the Ford/Rahall legislation which is intended to correct some of these ICC actions and to clarify congressional intent on these matters. In particular, I would hope that we could move especially expeditiously on the coal export matter, since this decision will have such a critical effect on our overseas sales and credibility. And finally in the course of the proceedings, I urge you to take particular precautions to address the unique needs of our smaller coal operators in any legislation you may develop.

Senator WARNER. Mr. Rogers, I certainly appreciate your speaking on behalf of the small operator. Indeed, Virginia has a parallel situation to the one that you describe, and as chairman, I am very conscious of this as we proceed with these hearings.

If there are no questions from my colleagues, we will thank you gentlemen for your very valuable contribution. You have framed the issue.

Mr. ROGERS. Thank you, Mr. Chairman.

Senator WARNER. We will now proceed to receive testimony from a panel of coal producers and buyers. We are privileged to have with us this morning Mr. E. Morgan Massey, president of A.T. Massey Coal Co., Richmond, VA; Mark R. Joseph, president, Anker Energy Corp., New York; C.R. Moore, president, Getty Minerals Marketing, Los Angeles, CA; Mr. Thomas Altmeyer, vice president, congressional and governmental affairs, Mining & Reclamation Council of America.

I would like to comment further that Mr. Joseph has also the responsibility of being the chairman of the Coal Exporters Association. Mr. Moore is the president of the Western Coal Export Council. Mr. Massey, we welcome you.

STATEMENT OF E. MORGAN MASSEY, PRESIDENT, A.T. MASSEY COAL CO., INC., RICHMOND, VA

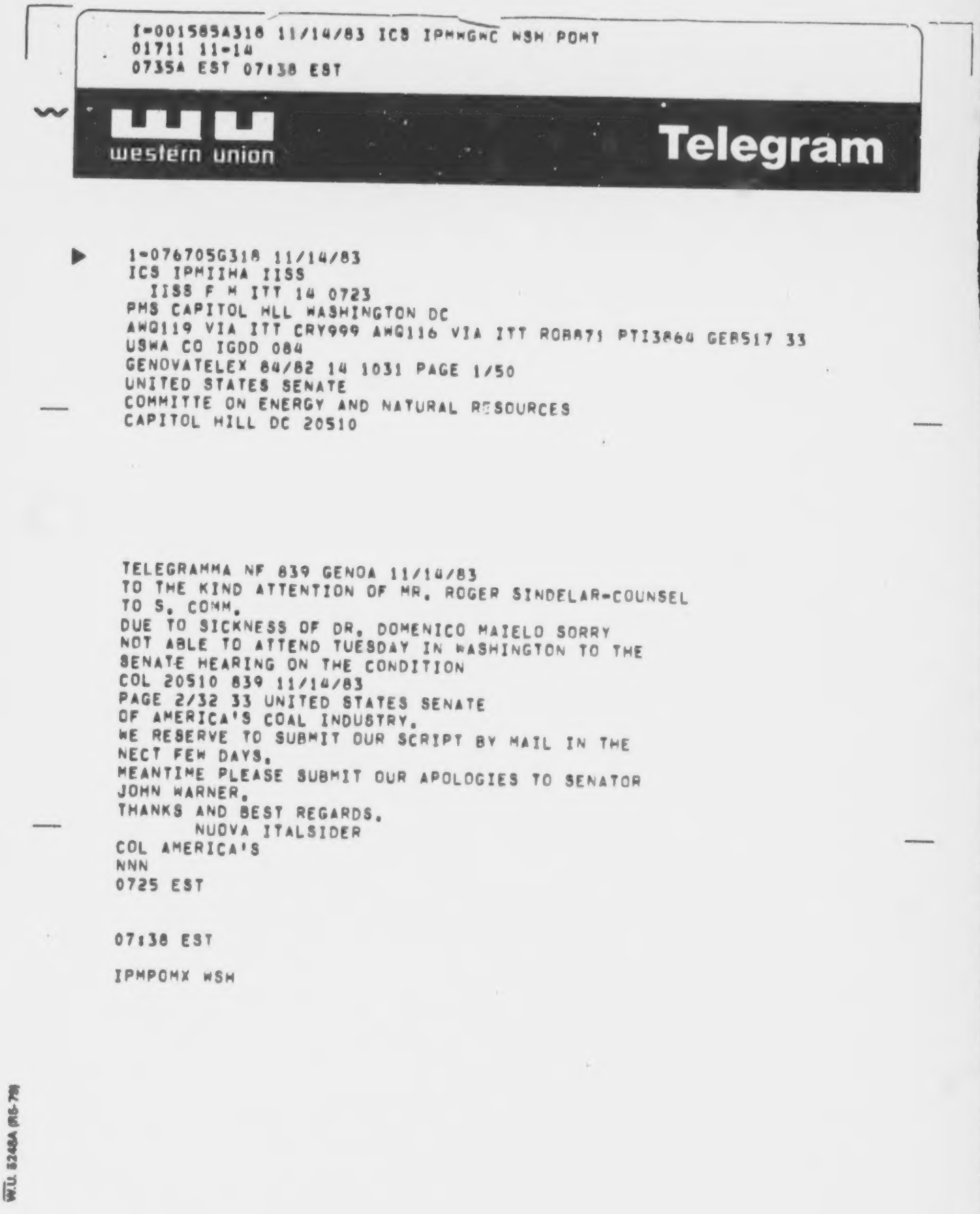
Mr. MASSEY. Thank you, Mr. Chairman. My name is Morgan Massey. I am president of the A.T. Massey Coal Co. which is headquartered in Richmond, VA. Our company produces and sells more than 20 million tons annually.

Senator WARNER. Mr. Massey, I am going to pause and ask if you move closer to that microphone. The sound leaves something to be desired. You really have to talk right into that mike. There are a number of people who have traveled long distances and are quite interested in hearing your testimony.

Mr. MASSEY. In 1982, we exported 5.1 million tons to our overseas customers. But in 1982, tonnage was about half what it was in 1980.

Mr. Maiello from Italsider was to be here with us today and he was detained because of the flu I suppose is the way it was described, and we are sorry that he could not appear. He was going to be on our panel.

[Subsequent to the hearing the following was received by the subcommittee:]



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Mr. MASSEY. Good; I commend you for holding these oversight hearings today on the condition of the coal industry and specifically on the ICC's recent decision to exempt railroad export coal traffic from all provisions of the Interstate Commerce Act.

Joining me today is Mr. Mark Joseph of Anker Energy Corp. Our statements are being presented on behalf of the National Coal Association and the Coal Exporters Association. The National Coal Association's membership includes coal producers, sales companies, and other organizations associated with America's coal industry.

The Coal Exporters Association represents producers and exporters responsible for the production and sale of more than 90 percent of the Nation's coal exports.

I would like to submit our statement for the record as it is quite long, Mr. Chairman. I ask your permission for Mr. Joseph and me to summarize our comments and to provide our full statement for the record.

Senator WARNER. They will be included in the record. We appreciate your offer to provide us with a summary.

Mr. MASSEY. I would like to begin by saying that the coal industry supports the reasons that the coal industry supported the rail reforms and rate flexibility included in the Staggers Rail Act of 1980 which we believed necessary to ensure a financially healthy rail system capable of making the investments necessary to build and maintain the rail transportation systems necessary for the cost-efficient movement of coal in the future.

Our support of the Staggers Rail Act was predicated on a notion that the regulatory process administered by the Interstate Commerce Commission would conform with the captive shipper provisions of the 1980 act and the intent of Congress in continuing protection against abuses in rail rates and services to which captive coal shippers are vulnerable due to the absence of transportation competition.

One purpose of Staggers—a financially healthy railroad industry—has certainly been realized. The internal cash flows of the railroads have been adequate to meet and exceed both the current operating requirements and the captive expenditures associated with the delivery of the railroad transportation services. But the second purpose of Staggers— to maintain regulatory control over rates and practices applicable to captive shippers—has not been realized due to the ICC's failure to be responsible and responsive to the transportation policy mandated by the act—to maintain reasonable rates where there is an absence of effective competition.

With respect to export coal, any captive shipper protection that might have been available under the Staggers Act has been completely eliminated by the Commission's decision in ex parte 346 sub 7 to totally deregulate rail movements of export coal.

I would like to ask Mr. Joseph to explain why we believe this to be true.

STATEMENT OF MARK R. JOSEPH, PRESIDENT, ANKER ENERGY CORP., NEW YORK, NY

Mr. JOSEPH. Mr. Chairman, as Mr. Massey mentioned, I am president of the Anker Energy Corp. My firm is both a trader and a producer of coal, exporting about 3 million tons per year and producing 2 million tons annually.

I am here today in my capacity as chairman of the Coal Exporters Association.

June 9, 1983, despite well-founded and widespread opposition on both legal and economic grounds, the International Commerce Commission issued a decision exempting export coal rail traffic moving through U.S. ports, including Great Lakes ports, from all provisions of the Interstate Commerce Commission control.

This exemption went far beyond the original request of the railroads for only the deregulation of rates by removing Commission jurisdiction in all other areas—car-hire service, the commodities clause, and the common carrier obligation.

Mr. Chairman, the coal industry has opposed deregulation of export coal rates from the outset. As I am sure you are aware, the CEA and NCA have challenged the ICC's recent decision in the U.S. Court of Appeals of the District of Columbia, and this case will be heard by a panel of judges in February or March 1984. This exemption decision clearly violates several aspects of rail transportation policy, including the most important one—to maintain reasonable rates where there is an absence of effective transportation competition.

More than 95 percent of mines producing coal for export are captive to a single railroad. There is essentially no competition from any other transport mode. In the absence of regulation, the lack of effective transportation competition at the coal mine will allow railroads to engage in discriminatory pricing practices. To discriminate is to levy service at a given mine location and to increase rail rates at will.

Reliance on world market geographic competition to hold coal rates at a reasonable level is a fallacious argument. The point of the competition in question is not the customer's coke plant and utility boiler. The point of the competition is the coal mine itself which does not have a competitive transportation mode available.

Contrary to the Commission's opinion, the coal exporters do not have the market power to prevent monopoly pricing by the railroads. The exporter cannot easily move his coal source from mine to mine or railroad to railroad. Over 80 percent of all U.S. export coal is tied through short-, intermediate-, or long-term contracts to a specific mine. This further reduces the possibility of source substitution. The coal producers and exporters cannot, as the Commission states, withhold shipments to bargain for lower rates. To carry out such a threat would mean the coal mine would shut down, an action more harmful to the coal producer than to the shipper.

The coal exporting industry is not concentrated but rather is an extremely diverse industry. Not even one exporting company is large enough to exert its own market power over the railroad. The coal shipper cannot threaten to channel their coal from the export to the domestic market to avoid a rail rate or a particular rail carrier.

The U.S. coal industry currently has a productive capacity which exceeds 1 billion tons annually, and its domestic demand is only 720 to 750 million tons annually. There is no room for export coal on the domestic scene. If the coal is not mined for export, it will remain in the ground.

Finally, abusive market power by one railroad cannot be checked by the possibility of inter- or intra-modal competition. Pipelines do not exist for the transportation of export coal and truck competition is not economically practical. Barge transportation almost always involves a prior movement by rail which makes the railroads indispensable to the water carriers' ability to carry coal.

The ICC decision in ex parte 346 sub 7 went far beyond the railroads' original petition for only rate deregulation on export coal by exempting coal export rail traffic from all provisions of the Interstate Commerce Act.

More importantly, this includes the guarantee of rail service by common carriers, protection against discrimination, and the application of the commodities clause. Through deregulation, the ICC has facilitated a railroad shipment of its own coal for export and has enabled the railroad to deny or limit service offered to nonrail-owned producers. The railroads hold all the cards, and under deregulation and in the absence of transportation competition, the coal exporters are literally in business only at the pleasure of the railroads.

Several analyses on the potential impact of rail deregulation on export coal traffic have been completed in the past 2 years. The basic conclusions are all the same. Deregulation of export rates will cause an increase in rail rates for export coal and will cause a reduction in the amount of coal exported in the future.

The Energy Information Administration recently published a report, "Railroad Deregulation: Impact on Coal," which concluded if rail rates for export coal are raised to the level necessary to reach revenue adequacy, U.S. coal exports will be 14.9 million tons lower in 1985, 27.2 million tons lower in 1990, and 36.6 million tons lower in 1995 under the base case assumption, and if rail rates for export coal are increased in real terms only 25 percent over levels which can be expected under continued regulation, the loss would be 14.8 million tons in 1985, 20.20 million tons in 1990, and 17.8 million tons in 1995. Increases that exceed 25 percent will result in greater losses.

The economic effects forecast by the EIA are not final. Hypothetically, although there has not been sufficient time since the Commission's decision went into effect on September 12 to assess completely the immediate market effect of that decision, we can conclude that the United States is losing some of its export markets due to rate decisions by the railroads. Railroad rates have been and continue to be insensitive to market conditions.

The world coal market has been stagnant in 1983 due to economic recession, a sharp drop in demand for electricity, ready availability of oil and natural gas at declining real prices, and a depression in the world steel industry. As a result, world coal trade in 1983 will be below the 250 million tons traded in 1982. It would logically be expected that all coal-exporting countries would share in any decline in the market.

That has not been the case. Rather coal exports from the United States have declined by 33 percent when compared with 1982 shipper rates. Conversely, shipments of coal from Australia, Canada, South Africa, the U.S.S.R., and Poland into our traditional European and Pacific rim markets have either remained at 1982 levels or have increased at our expense.

Given these poor markets, coupled with ready availability of coal from other sources, all elements of the coal-exporting chain must strive to cut costs to assist in keeping U.S. coals competitive so that we can at least keep the markets we have already have. Indeed at the end of September 1983, the average f.o.b. port price of metallurgical coal was $10 per ton lower than a year earlier, and the average f.o.b. price of steam coal for overseas destinations was approximately $6 per ton lower than a year earlier.

However, all the price reductions were made possible only by the actions of the coal producer and the coal exporter. The U.S. exporter has reduced the average mine price of his coal by over 20 percent in the last year. At the same time, according to data published in "Coal Week International," the average freight rate for coal shipped to Hampton Roads or to Baltimore has increased. The railroads have simply not done their part to keep the U.S. coal markets overseas and have not reacted as any business in a nonmonopoly should to market forces.

This statement is confirmed by recent actions of our long-valued customers in both Europe and in Japan. Again, Coal Week International recently reported that Denmark's Elkraft, a large power utility, has recently canceled contracts for 630,000 tons of American coal due to the unwillingness of a certain railroad to consider a lower freight rate. A recent visit by officials of ENEL, the Italian steam-coal buying agency, to plan 1984 steam company purchases for Italy, concentrated on the difficulties encountered when trying to obtain more reasonable railroad rates, and as a result, the United States stands to lose several million tons of this business.

Last year, ENEL purchased almost 3 million tons, or this year rather, 1983, they purchased almost 3 million tons of American coal.

The Japanese during recent discussions of the United States-Japan Energy Working Group stated their intentions to cut purchases of U.S. coal to no more than 2 to 3 million tons per year. One problem was high rail rates and an inability to negotiate more reasonable rates on a short-term basis.

Additional short-term losses are probable. The uncertainty created by the lack of knowledge of railroad actions and the railroads' willingness to make commitments causes the foreign customer to rethink any decision to purchase coal in the United States.

Furthermore, even if the exemption were later declared unlawful, foreign buyers would not necessarily resume their normal level of purchases with the United States because they likely would have increased their long-term contract purchases from South Africa and Australia—a measure of retaliation for what they see as an unfair U.S. Government policy.

Mr. Chairman, to conclude my remarks, Morgan Massey will conclude his summarization of our statement by giving you further examples of short-term effects of the Commission's decision on our export markets and by discussing the legislative remedies we believe necessary to correct the actions taken by the ICC.

Thank you.

Mr. MASSEY. In my detailed testimony I have circulated a simple chart showing the increases in rail tariffs to Hampton Roads and compared these with my own company's loss of export sales tonnage over the period since the Staggers Rail Act.

From the chart you can see that the typical tariff of the Kanawha district or in the Thacker district coal to Hampton Roads post-Staggers Rail Act increased 19.2 percent to the end of 1981. It increased another 19.2 percent by the end of 1982, and then went up another 19.2 percent by mid-1983. Resultingly, the export sales of our company which was just over 9 million tons in 1980 dropped to 7,968,000 tons in 1981, 5,126,000 tons in 1982, and will be no higher than 3,900,000 tons in 1983 even though our company has invested over $150 million in providing ground-storage coal terminals to improve the service at Hampton Roads and at Charleston, SC, that the railroads were unwilling to provide.

The tonnage lost on the national basis for this same period reflects a drop from 92 million tons overseas exports in 1981 to approximately 60 million tons in 1983. For 1984 we have been informed that our steam contracts—Mr. Joseph mentioned the Elkraft in Denmark, totaling over 600,000 tons, will not be renewed unless the railroads make a significant reduction in the rates at Hampton Roads.

Senator WARNER. Mr. Massey, do you suppose that you could superimpose on this chart another line showing your production costs through this same period?

Mr. MASSEY. Yes, sir.

Senator WARNER. What would that likely show. How would it track here?

Mr. MASSEY. There have been inflationary factors over that period. There is no question that the inflationary factors have been in the range of 6, 7, and 8 percent.

Senator WARNER. So you would have a curve with a gentle slope so to speak reacting to inflation?

Mr. MASSEY. The inflation curve would cut about 50 percent of the slope off of that, the railroad curve there.

Senator WARNER. Then again, you know, one of the things that we Republicans talk about is inflation having dropped from around 12 to 14 to 3. Is that reflected?

Mr. MASSEY. Well, actually the cost of producing coal has leveled off substantially. It was inflating in the 1977, 1978, 1979 period, but it has actually, with increased productivity, the cost of producing coal has actually come down in the 1981, 1982, 1983 period.

Senator WARNER. So the production curve would be humped over and headed down? Cost production of coal would be humping down?

Mr. MASSEY. Yes, sir.

Senator WARNER. I interrupted you.

Mr. MASSEY. I hope that I can speak frankly to my Senator from Virginia——

Senator FORD. We do. Go ahead.

Mr. MASSEY. Actually I feel that the Senate bill 1082 by itself is weak tea for solving the problems of overpricing rail transportation of coal. We believe that three things must be done to correct the problems we are having with the ICC.

First, the composition of the ICC must be changed to include representation of shipper interests who are not now represented on the Commisssion as expressed in a May 5 letter to the President signed by 27 chief executive officers of the major coal companies who previously supported the 1980 act, quote:

> We urge you to appoint to vacant positions on the Interstate Commerce Commission individuals who will recognize as Congress did by passing the Staggers Rail Act that adequate protection for captive shippers must be contended and that reduced regulation of the railroads is feasible only where sufficient competition exists to ensure reasonable rates.

Second, we believe that this legislation, S. 1082, is necessary to correct the damages done by the ICC. S. 1082 introduced in April 1983 by good Senator Ford and Huddleston of Kentucky will correct those inequities now faced by shippers captive to the railroads.

This bill would require the Commission to adhere to the comprehensive goals, policies and provisions of the 1980 act with regard to railroad ratemaking. S. 1082 defines railroad market dominance in the Interstate Commerce Act, prohibits the Commission from exempting market dominant railroad traffic from regulation, and provides the Commission with guidelines or standards in regard to rail rates and the determination of railroad revenue adequacy.

We believe the passage of this legislation is essential to assure sound implementation of the Staggers Rail Act of 1980. The thrust of the legislation is to restore in the regulatory process the balance furnished in the 1980 act. It will help to see that captive shipper protection against rail rate abuses will not be eroded through unwarranted de facto total regulation of captive traffic through the actions of the ICC.

Finally, we must give the railroads some competition through the passing of coal pipeline legislation.

We lost that battle in the Congress, but we are going to continue that in the State of Virginia, and that is one thing that will probably do more to reverse the problem than this bill by itself.

Mr. Chairman, we appreciate the opportunity to appear here today to discuss rate deregulation and its effects on our position in the world market.

We hope that the record built here today will be followed by congressional action. Inaction not only could but will result in a further erosion of the U.S. position in the world coal market.

We would be pleased to answer any questions that you may have.

[The prepared statements of Mr. Massey, Mr. Joseph, and Mr. Ogden follow:]

NATIONAL COAL ASSOCIATION

STATEMENTS OF
MARK R. JOSEPH
PRESIDENT
ANKER ENERGY CORPORATION

E. MORGAN MASSEY
PRESIDENT
A. T. MASSEY COAL COMPANY INC.

on behalf of
THE COAL EXPORTERS ASSOCIATION
and
THE NATIONAL COAL ASSOCIATION

BEFORE THE
U. S. SENATE
SUBCOMMITTEE ON
ENERGY AND MINERAL RESOURCES
of the
COMMITTEE ON ENERGY AND NATURAL RESOURCES

WASHINGTON, D.C.
NOVEMBER 15, 1983

Mr. Chairman, my name is E. Morgan Massey and I am President of A. T. Massey Coal Company in Richmond, Virginia which both produces coal and purchases coal from other producers for domestic and for export sale. My company produces and sells more than twenty million tons annually. Joining me today is Mark R. Joseph, President of Anker Energy Corporation in New York. Anker Energy is a trader and producer of coal, exporting more than three million tons and producing approximately two million tons annually.

We are appearing before you today on behalf of the Coal Exporters Association and the National Coal Association. CEA represents producers and exporters responsible for production and sale of more than 90 percent of the nation's coal exports. National Coal Association membership includes coal producers, transporters, sales companies and other organizations associated with America's coal industry.

We commend you, Mr. Chairman, for holding these hearings which have been called to assess the effects on the overseas markets for United States of the Interstate Commerce Commission's recent decision to exempt railroad export coal traffic from all provisions of the Interstate Commerce Act. This is the first Congressional discussion of the decision since its effective date, September 12, 1983.

Our joint statement will discuss four points:

. the reasons that the coal industry supported the rail reforms and rate flexibility included in the Staggers Act of 1980 which we believed would insure a financially healthy rail system capable of making the investments necessary to build and maintain the rail transportation systems required to haul coal in a cost effecient manner in future years;

- the failure of the ICC to implement the Act in the balanced manner required to preserve a reasonable amount of captive shipper protection. This was most recently evidenced by the Commission's decision in ExParte 346(7) to totally deregulate all railroad export coal traffic;
- the effects of Commission's decision on both the short and long range outlook for U.S. coal exports; and finally,
- steps that must be taken by the Congress to correct the actions of the ICC and to restore captive shipper protection that is the cornerstone of the Staggers Rail Act.

I. The Coal Industry Supports A Financially Healthy Rail Industry.

A sound rail industry is vital to the future of coal. Rail transportation is, in many cases, the only way that coal can be shipped from mines to market due to the bulk nature of coal and the large volumes which must be shipped long distances. Approximately two-thirds of U.S. coal production of some 800 million tons is now transported by rail. As coal reserves are developed in eastern and western locations far removed from the marketplace, coal's dependence on the railroad will increase.

Coal is equally important to the railroad, accounting for more than one-third of the total tonnage carried by Class I railroads.

Recognizing the interdependence of our two industries and the importance of a financially healthy rail industry, the National Coal Association supported the 1980 Staggers Rail Act because the Act:

- preserved a reasonable degree of captive shipper protection;
- authorized the use of transportation contracts;

- improved railroad pricing flexibility to furnish adequate railroad revenue and provide needed financial strength throughout the rail industry;
- enabled railroads to reduce costs of providing transportation services thru elimination of certain unnecessary and excessive regulations;

The enactment of Staggers, a major step toward deregulation of the rail industry, has proven to be very beneficial to the railroads. Railroad revenues have been enhanced significantly by the Act's creation of a cost recovery index which is adjusted quarterly to account for inflation, establishment of a zone of rate flexibility allowing rail rates to be increased above inflation each year in specified percentages, and encouragement of railroad transportation contracts which assure revenues over certain time periods in relationship to prescribed rates for movements covered by contractual agreements. (Rail carriers and shippers have been very successful in negotiating these long term contracts for specific coal shipments.) Furthermore, under the Act, railroad movements do not fall under ICC jurisdiction with regard to rate reasonableness unless the rates exceed the variable costs for the services by specified threshold percentages, representing a substantial reduction in rate regulation.

As a result of these provisions, coal carrying railroads are financially sound. In 1981, average rates of return on equity of coal-carrying railroads were 11.25 percent. Furthermore, under new methods of financial reporting established by the ICC, these rates of return should be raised by a factor of about 1.2 times. Thus, the rates of return on equity, if stated using the newly adopted reporting methods, were about the same as for manufacturing as a whole, which amounted to about 13.60 percent in 1981. Moreover, to underscore their financial strength, since 1980 the railroads have been able to satisfy most of their investment needs, and their internal cash flow has been adequate to meet, and to exceed, capital expenditures that are associated with the delivery of railroad transportation services.

The financial health of the railroads is well illustrated by the recent purchase of Texas Gas Resources by CSX or by the Burlington Northern's acquisition of El Paso Gas.

The Staggers Rail Act had two purposes: to deregulate railroad rates in competitive markets and to continue to maintain regulatory control over rates and practices applicable to "captive" shippers--those without competitive transportation alternatives. The coal industry's support of Staggers was predicated upon these protections provided to captive shippers. However, these protections have been seriously eroded by the ICC's implementation of the Staggers Act and the Commission's failure to provide a regulatory process that balances the financial needs of carriers, with the need of the captive shippers and the public.

With respect to export coal, any captive shipper protection that might have been available has been completely eliminated by the Commission's decision in ExParte 346(7) to totally deregulate rail movements of export coal.

II. ExParte 346(7) - Railroad Exemption Export Coal

A. Background

In March 1981, the N & W (now the Norfolk-Southern) filed a petition with the ICC requesting that the ICC issue a proposed rulemaking to exempt from its jurisdiction rail rates for export coal moving to Atlanta and Gulf Coast ports (ICC Docket #38272). Despite objections from NCA/CEA and other interested parties, on September 3, 1981, the ICC, under ExParte 346(7), Railroad Exemption Export Coal, extended the scope of the request and sought comments on the merits of exempting all export coal rail traffic through all U.S. ports from some or all ICC regulations.

Sec. 10505 of the Interstate Commerce Act as modified by Sec. 213 of the Staggers Rail Act provides that the ICC shall exempt a person, class of person or transaction of service from ICC jurisdiction, upon application of the carrier and wherever the Commission finds that:

1. Regulation is not necessary to carry out National Transportation Policy (as defined in the Staggers Act) and
2. Either (A) the service is of limited scope or (B) regulation is not needed to protect shippers from abuse of market power.

The ICC received comments from the railroads favoring deregulation and from coal shippers, foreign customers of United States coal, the Departments of State and Commerce and from several Members of Congress opposing deregulation. In addition to written comments, the ICC took the unusual step of holding oral arguments in June 1982.

Despite well-founded and widespread opposition on both legal and economic grounds, on June 9, 1983, the Commission issued a decision exempting export coal rail traffic moving to United States ports, including Great Lakes ports, from all provisions of the Interstate Commerce Code. This exemption went far beyond the original request for deregulation of rates only, by removing Commission jurisdiction in all other areas, car hire and service, the commodities clause and the common carrier obligation.

CEA/NCA have challenged the decision in the U.S. Court of Appeals of the District of Columbia. The case will be heard by a panel of judges in February or March, 1984.

B. The ICC Decision to Exempt Export Rail Rates

In issuing the majority decision (a 3-2 decision) to exempt export rail traffic from all provisions of the Interstate Commerce Code, the ICC found that:

1. The Exemption is consistant with National transportation policies as continued regulation of export traffic is not needed to carry out any of the elements of the rail transportation policy as defined by Staggers. The Commission argued that regulation is unnecessary to prevent predatory pricing; will encourage contractual arrangements; will allow the railroads to maintain and increase business through engaging in "selective" rather than uniform pricing of services; will encourage development of intermodal competition.

2. Regulation is not needed to protect shippers from the abuse of market power due to the nature of competition in the world coal market. The Commission argues that the world coal market is extremely competitive; there is sufficient geographic and product competition for coal to prevent an abuse of any market power the railroads might have; the railroads will act as an economically rational business and will not price their services at levels sufficiently high to cause a loss of business. Competition, it is claimed, is geographic - there is inter-regional competition within the United States, there is competition between the U.S. and other coal producing countries. There is also possible product substitution, i.e., other types of coal or oil or natural gas can be substituted for any specific coals from a particular mine. The Commission further argues that the railroads are not in a position to extract an undue share of economic rent as "coal exporters are an extremely concentrated industry with sufficient bargaining leverage to prevent unreasonable pricing by

railroads." The Commission also notes that there are safeguards to prevent abuse of market power: the antitrust laws of the Sherman Act and the ICC's power to re-regulate export coal traffic.

C. Coal Industry's Arguments Opposing Deregulation of Export Coal Rates.

The coal industry has opposed deregulation of export coal rates from the outset of this proceeding. We have argued, and continue to argue, that there is no legal or economic justification for either partial or total exemption of export coal rail traffic.

1. The exemption clearly violates several aspects of National rail transportation policy, including the most important one: "to maintain reasonable rates where there is an absence of effective competition." The Staggers Act of 1980 recognizes that the railroads have a monopoly power over coal traffic and guarantees an opportunity for shippers of captive traffic to secure Commission review of the maximum reasonableness of rates, for that traffic. As more than 95 percent of mines producing coal for export are captive to a single railroad, there is essentially no competition from any other transport mode. Railroads are market dominant for export coal.

In the absence of regulation, the lack of effective transportation competition at the coal mine will allow railroads to engage in discriminatory pricing practices; to discriminate as to level of service at a given mine location; to increase rail rates at will.

2. Continued regulation is necessary to protect the captive coal shipper from the abuse of market power and we are urging Congress to legislatively correct this inequity. As pointed out, nearly all export coal shippers are captive with no effecive transporation competition for coal shipments at any given point of production. Reliance on "world market", or geographic competition to hold coal rates at reasonable levels is a

fallacious argument. The point of competition in question is not the customer's coke plant or utility boiler. The point of competition is the coal mine itself, which does not have a competitive transportation mode available. Contrary to the Commission's opinion, the coal exporter does not have the market power to prevent monopoly pricing by the railroads.

The exporter cannot "easily" move his coal source from mine to mine or railroad to railroad as ICC Chairman Reese Taylor pointed out in his opinion dissenting from the majority view:

> "First, export tonnage is frequently a blend of coal from several mines, and many times, some mines are on one railroad, some on another. Second, for a shipper to be able to substitute tonnage from a mine on a second railroad, certain conditions must be met, i.e., the tonnage must be available and not already committed to a long- term contract, the extraction costs must be relatively the same, and the tonnage from the second mine must be technologically substitutable for the tonnage from the first."

Additionally, over 80 percent of all U.S. export coal is tied, through short, intermediate or long term contract, to a specific mine. This further reduces the possibility or source substitution.

The coal producers, exporter, cannot, as the Commission states, withhold shipments to bargain for lower rates. To carry our such a threat would mean that the coal mine would shut down - an action more harmful to the coal producer than to the railroad.

The coal exporting industry is not concentrated, but rather is an extremely diverse industry. Not even one exporting company is large enough to extert its own market power over the railroad.

The coal shipper cannot threaten to channel their coal from the export to the domestic market to avoid a rail rate or a particular rail carrier. First, coal cannot leave a mine unless by the railroad in question. Secondly, as the U.S. coal industry currently has a productive capacity which exceeds 1 billion tons annually, and as domestic demand is only 720-750 million tons annually, there is no room for export coal on the domestic scene. If the coal is not mined for export, it will remain in the ground.

Finally, abuse of market power by one railroad cannot be checked by the possibility of inter or intra-modal competition. Pipelines do not exist for the transportation of export coal, truck competition is not economically practical. Barge tranpsportation almost always involves a prior movement by rail which makes the railroad indespensible to the water carrier's ability to carry coal.

3. The ICC decision in ExParte 346(7) went far beyond the railroads original petition for only rate deregulation on export coal. The ICC decision exempted coal export rail traffic from all provision of the Interstate Commerce Act. Most importanly, this includes the guarantee of rail service by common carriers, protection against discrimination, and the application of the commodities clause. Thru deregulation, the ICC has facilitated a railroad's shipment of its own coal for export and has enabled the railroad to deny or limit service offered to non-rail owned producers.

These radical eliminations of key parts of the Interstate Commerce Act have no support in the record; they were not sought by the railroads; and the majority has offered no explanation for them.

Again, to quote the ICC Chairman Reese Taylor, "Under the exemption it would appear that coal owning railroads can now mine their own coal, haul it in their own cars, over their own tracks, to their own piers for export. As a consequence, independent coal producers will instantly, upon the exemption becoming effective, be confronted with a legal vertical monopoly against which it will be very difficult to compete."

The railroads have sufficient market power that the railroad can effectively determine the price levels at the mine, the distribution of profits (if there are any) between elements of the coal exporting chain, can determine which markets are served by which coal producers, and which coal producers and exporters participate in, or are excluded from, the export market.

The railroads hold all the cards and, under deregulation, and in the absence of transportation competition, the coal exporter literally, is in business only at the pleasure of the railroads.

III. What Effect will The Exemption Have on the U.S. Participation in the World Coal Market.

Several analyses on the potential impact of rail deregulation on export coal traffic have been completed in the past two years. All have reached the same conclusion—deregulation of export rates will cause an increase in rail rates for export coal and will cause a reduction in the amount of coal exported in the future.

The effects of deregulation on U.S. coal can best be discussed in the context of the competitive world coal market and the trends in coal use and trade.

A. The Long Range

1. Trends in Coal Use and Trade

Coal use in the major industralized nations (the OECD nations) increased by over 6 percent per year 1979 - 1981 due primarily to the substitution of coal for more expensive and unrealible oil in utility boilers and major industrial installations. The share of coal generated electricity in OECD nations jumped from 38 percent of total in 1978 to almost 45 percent of total in 1981.

This sharp increase in coal use (almost 100 million short tons outside of the United States) caused a corresponding jump in coal traded in the world market. Demand for steam coal increased by over 50 percent in just 18 months time (1979 - 1981), total coal traded increased by over 53 million short tons or by almost 20 percent during the same time period.

The reasons for the sharp increase in coal use and trade are well documented and will not be repeated here. The real question to be answered - will the trend continue?

Forecasts made in the shadow of the 1979 increase in oil prices said yes - demand for steam coal in the world market would increase at a 7-12 percent annual rate through the end of the century. Forecasts made today, looking at the realities of lower economic growth, higher energy prices, increased energy efficiencies and conservation suggest otherwise. GNP growth rates in OECD Europe are expected to average 1.9 percent through 2000 (versus an average 4.7% 1960 - 1972) and in Japan will average 3.3% (versus 10.4% 1960 - 1973 and 4.4 percent 1974 - 1981.) Average increases in energy use will be marginally lower.

Preliminary forecasts prepared by the Export Subcommittee of the National Coal Association Economics Committee suggest that steam coal use will increase at approximately 5% per year and import requirements will increase, on average, by just over 6 percent per year through 1995. Steam coal import demand should reach a total of 127 million tons in 1985, 189 million in 1990 and 250 million in 1995. (These forecasts, discussed in Appendix A, are approximately 12% lower than the forecasts of approximately 6 - 8 months ago.)

Most of the increase in demand for steam coal will be for use in utility boilers. Industrial use of coal will not increase appreciably before 1990. Demand for imported steam coal will be greatest in Europe.

Demand for metallurgical coal on the world market will stabilize at approximately 140 - 145 million tons annually.

WORLD COAL TRADE -- 1980 - 1995 1/

(million short tons)

	1980	1985	1990	1995
Steam	100	127	189	250
Met	138	137	142	145
TOTAL	238	264	331	395

1/ Excludes COMECON trade which is estimated at 30-35 million tons per year.

2. The United States' Share of the World Coal Market

The United States has been a prime beneficiary of the increase in demand for coal due to the initial inability of indigenous (EEC) producers to keep pace with the rate of increase in demand, and the short term unavailability of coal from competing sources due to political and labor problems. The U.S. coal industry had and has, the capability to meet any sudden increase in demand as the industry is operating at far less than annual productive capacity.

Although extreme problems were experienced in the transportation and port sectors, the coal industry had no difficulty in producing the quantities of coal required to support an increase in steam exports overseas from 2.6 million tons in 1979 to 33 million tons in 1981 and simultaneously increasing met coal shipments from 43 million to 60 million tons.

Despite its many advantages, the role that the United States will play in the future world coal market depends upon many factors including the supply capability of competing (and less expensive) coal producing and exporting countries and the capability of the U.S. exporter to deliver a product that is competitively priced with other available coals.

As discussed in Appendix A, Canada, Australia and South Africa have expanded production and export capability rapidly and, given reduced market demand, will be in a position of excess production capacity for some time.

It will be difficult for the United States to meet competitor's prices. But, despite this fact, some base quantities of coal (which could be very small if we are not price competitive) will be purchased from the United States for security, political, reliability, and diversity of supply reasons.

Future coal exports could be in the following range:

U.S COAL EXPORTS OF COAL, 1985, 1990, 1995

(million short tons)

	1980	1982	1985	1990	1995
Steam	27	40	31 - 45	45 - 69	61 - 90
Met	63	65	50 - 66	51 - 67	52 - 67
TOTAL	90	105	81 -111	96 -136	113 -157

As can be seen, given certain conditions - poor economic growth, low growth in the use of coal, availability of coal from competing nations and high cost of U.S. coal due to high rail costs, and high shipping costs - exports of U.S. coal could just reach 1981 levels by 1995.

On the other hand, if economic conditions improve, and coal use increases, the U.S. could increase exports to as much as 157 million tons by 1995. But, given the expected supply capability and price structure of competitive countries, attainment of these higher forecasts will require that costs of coal from the United States can be competitive or nearly competitive. This requires that rail rates remain at reasonable levels. and that rail service to all mines competing in the export market continue.

3. Economic Effects of Deregulation

The Energy Information Administration recently published a report "Railroad Deregulation: Impact on Coal" which concluded:

- if rail rates for export coal are raised to the level necessary to reach "revenue adequacy," U.S. coal exports will be 14.9 million tons lower in 1985, 27.2 million tons lower in 1990 and 36.6 million tons lower in 1995 than under base case assumptions.

- if rail rates for export coal are increased in real terms only 25% over levels which can be expected under continued regulation, the loss would be 14.8 million tons in 1985, 20.2 million in 1990 and 17.8 million in 1995. Increases that exceed 25% will result in greater losses.

The business lost to the United States will go to Australia, Canada, South Africa and to COMECON nations.

EIA concluded that even though the railroads would haul smaller tonnages, revenues would rise as a result of rail rate increaeses.

The economic effects on the coal industry are severe. Assuming a 25 percent increase in rail rates in real terms, gross export revenue lost to the coal producers would approximate $990 million in 1985, $1.2 billion in 1990 and $1.1 billion in 1995. Conversely, the net revenue additions to the railroad coffers would be $84 million in 1985, $100 million in 1990 and $200 million in 1995.

Losses will go beyond the loss of revenues. The members of CEA/NCA face the serious risk that an arbitrary act by a rail carrier--such as a sharply higher rail rate or an interruption of service--will cost them both short and long term export business and customers. Should this happen, investments in coal mines, preparation plants and coal piers will be lost. Unemployment in the affected coal fields will increase over already unacceptable levels. This is because virtually all mines are captive to a particular railroad and contracts with foreign customers require coal from specific mines. As a result, these producers will not be able to assure their customers that they can obtain rail transportation and do so at reasonable rates.

B. Short Term Effects of the Commissions Decision

The economic effects forecast by the EIA and other noted economists are not hypothetical. Although there has not been sufficient time since the Commission's decision went into effect on September 12 to completely assess the immediate market effects of that decision, we can conclude that the U.S. is losing some of its export market due to rate decisions by the railroads.

Railroad rates have been, and continue to be, insensitive to market conditions. The world coal market has been stagnant in 1983 due to economic recession, a sharp drop in demand for electricity, ready availablity of oil and natural gas at declining real prices, a depression in the world's steel industry. As a result world coal trade in 1983 will be below the 250 million tons traded in 1982. It would logically be expected that all coal exporting countries would share in any decline in the market. This has not been the case. Rather, coal exports from the United States have declined by 33 percent when compared with 1982 shipment levels. Conversely, shipments of coal from Austrailia, Canada, South Africa, the U.S.S.R. and Poland into our traditional European and Pacific Rim markets have either remained at 1982 levels or have increased at our expense.

Given these poor market conditions, coupled with ready availability of coal from other sources, all elements of the coal exporting chain must strive to cut costs, to assist in keeping U.S. coals competitive so that we can at least keep the market we already have. And, indeed, at the end of September, 1983, the average f.o.b. port price of metallurgical coal was $10.00 per ton lower than a year earlier and the average f.o.b. price of steam coal (for overseas destinations) was approximately $6.00 per ton lower than a year earlier. However, all the price reductions were made possible only by the actions of the coal producer and the coal exporter. The U.S.

exporter has reduced the average mine price of his coal by over 20 percent in the last year. At the same time, according to data published in "Coal Week International", the average freight rate for coal shipped to Hampton Roads or to Baltimore has increased. The increases are very small to be sure, but the railroads have simply not done their part to keep the United States coal markets overseas and have not reacted, as any business in a non-monopoly should, to market forces. Although not pricing U.S. coal totally out of the market, these rates are causing and will continue to cause foreign buyers to shift their purchases to other countries.

The Department of Commerce has concluded that there are "signs that this loss (i.e., the 30 percent reudction in coal shipments from the United States) is due in part to high and increasing rail rates, and to the perception on the part of foreign purchasers that rates for the rail transportation of U.S. export coal will not likely be subject to any form of regulatory restraint in the future. Once those buyers' orders have been filled elsewhere, U.S. producers will have great difficulty recapturing that business."

This statement is confirmed by actions of our long valued customers in both Europe and in Japan. "Coal Week International" recently reported that Denmark's ELKRAFT has recently cancelled contracts worth 630,000 tons due to the unwillingness of a certain railroad to consider a lower freight rate. A recent visit by officials of ENEL, to plan 1984 steam coal purchases for Italy, concentrated on the difficulties encountered when trying to obtain more reasonable rail rates and as a result, the U.S. stands to loose several million tons of this business. The Japanese, during recent discussions in the U.S.-Japan Energy Working Group, stated their intentions to cut purchases to U.S. coal to no more that 2 - 3 million tons per year. The problem - high rail rates and an inability to negotiate more reasonable rates on even a short term basis.

Additional short term losses are probable. The uncertainty created by the lack of knowledge of railroad actions and the railroads' unwillingness to make commitments causes the foreign customer to rethink any decision to purchase coal in the United States.

Furthermore, even if the exemption were later declared unlawful, foreign buyers would not immediately resume their former level of purchases from the United States because they likely would have increased their long-term contract purchases from South Africa and Australia, and may engage in a measure of "retaliation" for what they see as unfair U.S. government policy.

IV. Actions Necessary to Correct the Effects of the ICC's Decision

The ICC's decision to deregulate export coal is but one of many Commission actions which are eliminating through regulation, the adequate captive shipper protection which was included legislatively in the Staggers Rail Act.

There are several areas in which the Commission's failure to protect captive shippers is most evident:

- ExParte No. 320 (Sub-No. 2), Railroad Market Dominance: The Commission, in July 1981, decided that product and geographic competition would be standards used to determine whether rail market dominance exists for certain traffic at issue. This has no direct bearing on the question of shipper captivity to railroad transportation. Instead, the basic determinant of railroad market dominance clearly is whether effective transportation competition, intermodal or intramodal, exists for a particular movement. If the ICC's decision prevails, we would be faced with de facto deregulation of captive traffic, notwithstanding provisions of the 1980 Act.

- ExParte No. 347 (Sub-No. 1), Coal Rate Guidelines: The proposal of the ICC to allow railroad coal rate increases of 25 percent per year above inflation is arbitrary and in serious conflict with the Act. Not only does the proposal exceed by far the rate flexibility provisions of the Act, it clearly would subject captive coal traffic to rate abuses leading toward serious harm to coal producers, coal users, coal exporters, and consumers of electricity, due to excessive and unwarranted rail rates.

- ExParte No. 393 (Sub-No. 1), Standards for Revenue Adequacy: The ICC's decision to utilize a rate of return equal to the current cost of capital as the measure by which revenue adequacy is decided has serious flaws. Other indicators of financial strength also should be examined, and, in any event, the rate of return must be calculated using a rationalized rate base. In other words, the rate base embodied in the calculation should include only assets which are used and useful in providing transportation services and these should be depreciated to present value governed by commonly accepted accounting standards.

Legislative action is necessary to correct the damages done by the ICC. S.1082 introduced in April, 1983 by Senators Ford and Huddleston, will correct those inequities now faced by shippers captive to the railroads. This bill would require the Commission to adhere to the comprehensive goals, policies, and provisions of the 1980 Act with regard to railroad ratemaking. S. 1082 defines railroad market dominance in the Interstate Commerce Act, prohibits the Commission from exempting market dominant railroad traffic from regulation, and provides the Commission with guidelines for standards in regard to maximum rail rates and the determination of railroad revenue adequacy. We believe that passage of this legislation is essential to assure sound implementation of the Staggers Rail Act of 1980.

The thrust of the legislation is to restore in the regulatory process the balance furnished in the 1980 Act, particularly to see that captive shipper protection against rail rate abuses will not be eroded through unwarranted, de-facto total deregulation of market dominant traffic through regulatory exemptions and adoption of new standards for rail rates and revenues designed to encourage railroads to charge excessively high prices for services required by captive shippers.

Mr. Chairman, the need for this legislation is discussed more completely in the statement of Mr. S. O. Ogden which was presented to the Senate Surface Transportation Subcommittee on July 26, 1983. This statement is appended to my testimony and we would ask that it be submitted for the Record.

Mr. Chairman, we appreciate the opportunity to appear here today to discuss export rate deregulation and its effects on our position in the world market. We hope the record built here today will be followed by Congressional action. Inaction not only could, but will, result in a further erosion of the United States position in the world coal market.

We would be pleased to answer any questions you may have.

APPENDIX A

FUTURE COAL TRADE

Forecasts completed in late 1979 and early 1980, immediately after the Iranian oil crisis and resultant sharp increases in the price of oil, were very optimistic about future growth in the use of coal.

The oft cited "World Coal Study", released in May 1980, forecast world steam coal import requirements in 1985 as 120-175 million short tons 1/ and in 2000 as 345 to 782 million tons. The Interagency Coal Task Force report, published in January 1981, was 565 million bytons the year 2000.2/

National Coal Association was not immune to the aura of optimisim. In 1981, NCA released a long range forecast paralleling the Interagency Task Force Report.3/

The experience of 1979, 1980 and 1981 suggested that these forecasts would indeed become reality. Coal use increased rapidly, especially in Europe, due to utility conversions, and increased industrial and home heating use. Demand for steam coal on the world market increased by 50 percent in just 18 months. 4/ Total coal traded increased by almost 20 percent in the same time (Table 1). 5/

The United States was a prime beneficiary of this increase. Steam coal shipments to overseas destinations increased from 2.6 million tons in 1979 to 33 million tons in 1981. Simultaneously, exports of metallurigical coal soared from 43 million tons to 60 million tons (Table 2). The reasons for the increase in trade, and the very important role that United States coals played in meeting this new demand, are well documented and include:

- an increase in the demand for steam coal due to the short term decision to convert utilities from oil firing to coal and to quickly convert large industrial fuels users to coal wherever possible, coupled with;

- the inability of domestic, i.e. EEC, producers, to keep pace with increases in demand; and

- unavialability of coal from Australia and Poland due to strikes and political problems which forced a demand for "replacement" coal.

The rate of increase in demand for coal in the world market, and from the United States slowed appreciatively in 1982. World recession, coupled with increased energy efficiencies slowed the increase in use of electricity; steel, and thus coke production, declined, oil became readily available and the immediate urgency to convert industrial boilers (and additional utility boilers) disappeared. Coal traded on the world market did not increase in 1982 and is expected to decrease in 1983.6/ Simultaneously, new coal production and transportation infrastructure planned and started during the "Boom of 1980" began to come on line. Australia and Poland returned to more normal production levels.

The resulting supply glut on the coal market and resultant price pressures, have caused coal producers, transporters, port authorities to relook the future for coal use and trade and to reconsider expansion and investment plans made in the hayday of 1980.

In the future, overall demand for energy will not increase at the same high rate as in the past. Structural changes in energy economics, increased efficiency in energy utilization and conservation practices have caused a drop in the amount of energy required to produce each unit of GNP (or GDP). The "total energy requirement per unit of GNP" ratio has fallen 13% since 1973 and is expected to decline another 10% by 1990.7/ At the bottom line, when the world economy begins to improve, energy consumption - and thus demand for fuels including coal - will not increase apace.

What does this mean for the future of coal trade - and most specifically for the outlook for exports of coal from the United States.

The NCA Economics Committee is now revising its long range forecast taking into account lower economic growth, increased efficiency in use of energy, and availability of oil over a wide price range. The following discussion is based on the work in progress.

METALLUGICAL COAL

The overall demand for met coal on the world market will remain stagnant through 1995. Lower demand for steel, technological advances in the coke and steel making processes (which lowers the amount of coal required per ton of steel) will combine with an increase in the use of steel substitutes to cause a decline in the demand for met coal in the industrialized traditional steel making countries. Construction of steel production facilities in developing countries (and thus a requirement for coking coal in these areas) will almost offset the aforementioned decline.

Met coal traded on the world market is expected to stabilize at about 140-145 tons annually with a decrease in imports by the EEC countries and Japan, and increase by South Amercan countries, other Europe (non-EEC) and in other countries such as Korea. The United States share (33%) of this market is expected to remain about the same with an expected shift in destinations. Japan, although always an important factor for the United States in this market is expected to average about 15-17 million tons per year (although as in the past, there will be years in which the Japanese require more coal and there will be years when the Japanese take will be substantially less).

Met coal will continue to be shipped overseas from Hampton Roads, Baltimore, Mobile, Philadelphia. We do not expect more than 1 million tons per year to exit via West Coast ports, or in quantity from other ports.

STEAM COAL

As discussed in an earlier section of this report, optimistic forecasts of rapid growth in the use, and thus the trade, of steam coal have been used as the basis for ambitious expansion plans in the coal fields, by railroads and barge lines, by the ports.

Although one must avoid the whoop and moan school of forecasting (and right now it is easy to "moan"), a realistic look at demand for steam coal over the next 12 years shows a very different picture than that painted 2-3 years ago.

Due to factors already cited, slower economic growth, a decline in the rate of growth in the use of energy and thus electricity, increased efficiencies in energy and fuel utilization, conservation, availability of oil, natural gas and nuclear power, demand for coal to use under utility boilers will increase at a slower rate than previously expected.

Beyond use of coal in cement plants which is already an accomplishment, the rate of increase in demand for use of coal in industrial boilers is in question. As a recent IEA study 8/ pointed out:

> "The potential for coal use in industry is much greater than realized, but there are formidable obstacles to be overcome including:
>
> - a slow turnover in the relatively new stock of boilers, now oil and gas;
> - the impact of the recession on business activity combined with conservation and lack of financing makes near term conversion to coal less a priority;
> - coal boilers are more expensive than oil or gas, and although fuel is cheaper handling and waste disposal is a greater problem.
> - in today's economy, playback is too long for most industrial users, especially given today's oil-coal price spread;
> - the infrastructure and distribution system to serve small users is not yet in place."

This essentially means that, given business as usual with no government incentive, coal use in industry will remain relatively flat through 1990 and then increase at a relatively slow pace through 1995.

Taking these factors into account, steam coal import demand will be no more than 127 million tons in 1985 (as opposed to 100 million in 1980 and 113 million in 1982), will aproximate 189 million in 1990 and 250 million in 1995.

The share of this market actually filled by the United States depends upon the supply capability of our coompetitor countries. But, as the high cost supplier, it is a safe assumption that the United States will be the exporting country most affected by the reduction in forecast steam coal demand during this period. In a period of over supply, higher costs offset the natural advantages the United States has - a reserve base, a competitive industry, high quality coals, and stability of supply.

The United States has not gained many long term contracts to supply steam coal in Europe (and even fewer in Japan), and uncertain policies on transportation costs, i.e., rail, and port improvements are giving the customer an excuse to delay commitments. Coal is and, through 1995 will be available from lower cost suppliers meaning the U.S. will, in all probability, remain the swing coal supplier for the rest of this decade and into the next.

COMPETITION IN THE MARKET

A prime determinant of the U.S. participation the world coal market - both met and steam - is the supply capability of competitor countries. As mentioned, and ample suply of coal will be available at least through 1995 from Australia, Canada, South Africa and Poland. Columbia and China will participate in the market in the mid to late 1980's.

Australia: In the last decade Australian coal exports have increased from a minimal level to become the second larges coal exporter, after the U.S. Although most of the current coal exports are for metalurgical requirements, Australia is capable of participating strongly in the world steam coal market. Australian coal reserves are favorably located in the densely populated east, with geological characteristics encouraging development at relatively low costs. Australia exports more coal than is consumed domestically, unique among exporters and could indicate a potential limit on total exports. Most export mines are modern, highly efficient operations. The sharp growth of the export sector has strained capital development and improvements are required for substantial expansion of infrastructure, however, prospects are good that the Australian coal industry, supported by foreign investment and positive government interest can participate vigorougly in the growing coal trade. The unique labor situation has produced periods of labor curtailment for political, economic and jurisdictional reasons indicating coal exports may be vulnerable to this provblem in the future. The Australian coal industry is heavily dependent on the export trade and is particularly vulnerable to union strike activity.

Due to the poximity to the Pacific Rim countries, Australian coal has dominated this region. However increased requirements for a more diverse source of supply, particularly in Japan, could limit coal growth. The Australian coal exports to Europe have been severely impacted by the long distance and high freight costs. Large bulk carriers have reduced these transport costs. Australia will continue to be the major coal supplier to the Pacific region with reduced exports to Europe for the next decade, with exports in the 100-120 million ton range in the early 1990's.

Canada: Canada is an old coal producer, but a relatively new and agressive exporter. The main coal resources in Canada are located in the west, limiting their primary market to the Pacific Rim. Surface transport costs could be substantial, however the new Robert Bank Coal port near Vancouver has capacity for 150,000 ton vessels.

South Africa: South Africa has vigorous coal economy and the only large scale coal conversion program in operation, the SASOL project. Although the primary market is for domestic consumption, the export sector has expanded vigorously due to low costs of production and excellent port infrastructure. The potential for political change in South Africa could result in concern by potential consumers in long term supply security. Coal export levels are determined by the government but are now limited by port capacity. The Richards Bay coal port, a modern efficient facility, is now expanding to 45 million tons per year capacity and could go to 80 million tons by 1995. 9/ Africa will continue to be the low priced supplier of international coal.

Poland: Poland is a long term supplier to European coal consumers, but the political problems of the last several years have impacted production and curtailed exports, raising questions of the long term prospects for this country. For the mid-term, exports to Western Europe may be limited by reduced production, increased internal requirements and demand from other Eastern European Countries, however, Poland will aggressively market coal in the Western European area with expectations of returning to a 25-30 million ton export level by 1990.

Columbia: Columbia contains the largest known coal reserves in South America but currently produces only enough to suit domestic requirements. It has the potential to become a significant participant in the world coal trade as a number of new projects are implemented by 1990. The el Cerrejon project is expected to be operational by mid-decade and already has contracts for the greater percentage of its output.

China: China contains massive coal reserves, unlimited low cost labor, a highly centalized political system and a strong potential market in the Pacific area. However, the coal industry in China will require substantial foreign investment to modernize the infrastructure for mining and transportation. The economy of China is coal based and the primary coal developments would be for domestic requirements, although the export sector could participate in the coal expansion.

SUMMARY

For reasons of supply diversity and supply security, we believe that through 1990 steam coal will be purchased from the U.S. in at least as great a quantity as today - although those purchases may be spot and not long term contract puchases. If cost differentials narrow, through port improvements, lowering of rail freight rates, etc., and/or equity investments are made in U.S. facilities and/or the U.S. exporter reacts innovatively to new market oppotunities, an increase in tonnage (not market share) shipments will occur.

U.S. EXPORTS OF COAL, 1985,1990,1995
(million short tons)

	1980	1982	1985		1990		1995	
			Low	High	Low	High	Low	High
Steam	27	40	31	45	45	69	61	90
Met	63	65	50	66	51	67	52	67
Total	90	105	81	111	96	136	113	157

TOTAL WORLD COAL TRADE - 1985,1990, 1995 1/
(mid case - millio short tons)

	1980	1985	1990	1995
Steam	100	127	189	250
Met	138	137	142	145
Total	238	264	331	395

1/ Excluding Comecon trade estimated at 30-35 million tons per year.

1/ Wilson, Carroll L. "Coal Biridge to the Future", Report of the World Coal Study, Ballinger Publishing Company, Cambridge, Mass., May 1980

2/ U.S. Department of Energy, "Interim Report of the Interagency Coal Export Task Force", Washington, D.C., January, 1981.

3/ A Forecast for U.S. Coal in the 1980′s", National Coal Association, Wash., D.C., January, 1981.

4/ "Coal Trade Report", H. Clarkson & Co., London, England, #53, May 10, 1983.

5/ World Coal Magazine, November - December, 1982

6/ "Coal Trade Outlook to 1990", H. Clarkson & Co., London, England, February, 1983.

7/ "World Energy Outlook", International Energy Agency, Paris, France, Ocotber, 1981.

8/ "The Use of Coal in Industry", A report by the Coal Industry Advisory Board, IEA, Paris, France, May, 1982.

9/ de Villiers Leach, J. G., "South Africa — Background Notes", Presented to Coal Trans 81, October, 1981.

Table I.

WORLD COAL TRADE - A DECADE OF CHANGE
(million short tons)

	1970 1/		1979 1/		1980 1/		1981 1/	
Major Exporters	Tons	% Share	Tons	% Share	Tons	% Share	Tons	% Share
United States	71.7	38.4	66.0	25.9	91.7	32.3	112.4	37.0
Australia	19.8	10.6	44.6	17.5	47.2	16.6	56.2	18.4
Canada	4.4	2.4	15.3	6.0	15.8	5.6	18.0	5.9
United Kingdom	3.5	1.9	2.6	1.0	5.3	1.9	10.4	3.4
South Africa	1.7	0.9	25.7	10.1	31.4	11.1	32.9	10.8
Poland	31.8	17.0	45.6	17.9	34.5	12.2	16.6	5.5
USSR	27.0	14.5	28.4	1.1	28.2	9.9	24.2	8.0
China	0.3	0.2	1.7	0.7	6.8	2.4	7.2	2.4
Other	26.4	14.1	25.0	9.8	22.7	8.0	26.0	8.6
Total	186.6	100.0	254.9	100.0	283.6	100.0	303.9	100.0
Major Importers								
Canada	18.9	10.2	19.4	7.6	17.5	6.4	16.3	5.5
South America	3.4	1.8	6.9	2.7	6.7	2.3	5.3	1.7
EEC[2]	59.5	31.9	86.9	34.1	100.9	36.9	100.4	33.0
Other Europe	16.5	8.8	20.5	8.0	22.0	7.8	27.1	8.9
Communist Block	31.8	17.0	40.2	15.8	33.6	13.0	28.4	9.3
Japan	55.3	29.7	64.5	25.3	75.6	27.0	86.3	28.4
Other	1.2	0.6	6.5	6.5	27.3	6.8	40.1	13.2
Total	186.6	100.0	254.9	100.0	278.2	100.0	303.9	100.0

[1] Source: World Coal Magazine, November/December 1982.
[2] All years adjusted to include 10 EEC Countries.

Table 2.

WORLD-WIDE DEMAND FOR U.S. BITUMINOUS COAL: 1975-1982
(Millions of Net Tons)

	Canada			Overseas			Total		
Year	Met	Steam	Total	Met	Steam	Total	Met	Steam	Total
1975	7.2	9.5	16.7	44.4	4.6	49.0	51.6	14.1	65.7
1976	7.3	9.2	16.5	40.5	2.4	42.9	47.8	11.6	59.4
1977	6.6	10.6	17.2	35.3	1.2	36.5	41.9	11.8	53.7
1978	6.0	9.2	15.2	23.8	0.4	24.2	29.8	9.6	39.4
1979	7.6	11.6	19.2	42.7	2.6	45.3	50.3	14.2	64.5
1980	6.3	11.6	12.9	56.8	15.2	2.0	63.1	26.8	89.9
1981	5.8	12.0	17.9	59.4	33.0	92.4	65.2	45.0	110.2
1982	4.9	13.3	18.2	59.7	27.4	87.0	64.6	40.7	105.2

SOURCE: Bureau of the Census, U.S. Department of Commerce.

TABLE 3a

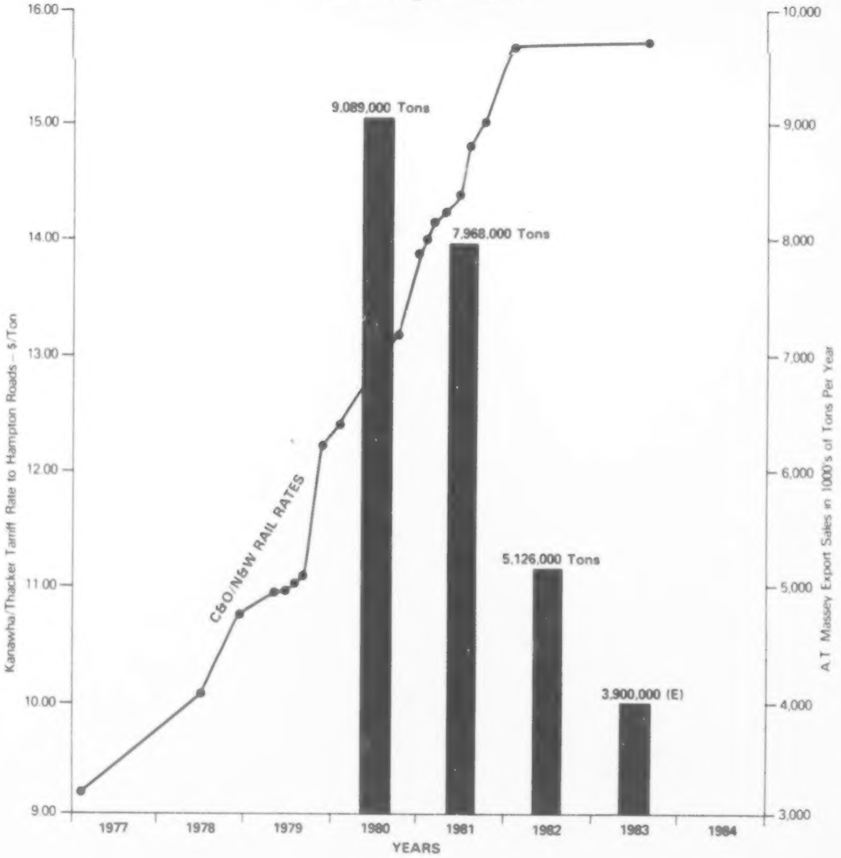
IMPORTS OF STEAM COAL 1/
MODERATE GROWTH CASE
(million of short tons)

Importer	Actual 1980	 1981	 1982 p/	Forecast 1985	 1990	 1995
Europe						
Austria	—	—	—	1	2	3
Belgium	6.6	6.4	6.8	7	9	11
Denmark	11.0	12.0	10.6	12	14	16
Finland	3.3	4.5	4.0	5	6	8
France	20.9	19.0	14.6	15	18	20
Germany (West)	9.2	11.2	11.1	11	15	18
Greece	0.2	0.2	0.5	1	2	4
Ireland	1.3	1.4	1.4	2	4	5
Italy	6.4	8.5	10.1	10	20	28
Luxembourg	0.4	0.3	0.3	2/	1	2
Netherlands	4.1	5.2	6.0	6	8	9
Norway	0.1	0.2	0.2	2/	2/	2/
Portugal	—	—	—	2	4	5
Spain	1.8	3.5	3.9	5	8	12
Sweden	0.4	0.6	0.6	1	5	8
Switzerland	0.6	1.0	0.5	1	2	3
Turkey	—	—	—	1	2	5
United Kingdom	5.4	1.9	1.5	2/	2/	2/
TOTAL EUROPE	71.7	75.9	72.1	80	120	157
Pacific Rim						
Japan	7.0	12.8	14.0	16	28	37
Korea	3.3	5.4	5.3	6	8	14
Taiwan	2.0	4.0	3.6	5	8	12
Hong Kong	1.0	1.2	1.6	3	5	8
TOTAL PACIFIC RIM	13.3	23.4	24.5	30	49	71
Other						
Canada	10.4	10.5	11.0	10	9	8
United States	1.2	1.0	0.7	1	1	1
South America	—	0.2	—	1	2	3
Other	3.5	4.0	4.5	5	8	10
Total 1/	100.1	115.0	112.8	127	189	250

1/ Includes only countries listed. Does not include inter East European or inter COMECOM TRADE.

2/ Less than 500,000 tons.

A.T. Massey Coal Company Export Sales Compared to Rail Freight Rates



NATIONAL COAL ASSOCIATION

STATEMENT

OF

S. O. OGDEN

PRESIDENT

SUNEDCO COAL COMPANY

ON THE

STAGGERS RAIL ACT OF 1980

TO THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION

UNITED STATES SENATE

JULY 26, 1983

WASHINGTON, D.C.

Mr. Chairman, my name is S. O. Ogden. I am president of Sunedco Coal Company. I am appearing before you today on behalf of the National Coal Association. NCA represents coal producers, coal sellers, and other organizations associated with America's coal industry. I am a member of NCA's board of directors and serve as chairman of NCA's Transportation Committee.

We commend you, Mr. Chairman, for holding hearings on the 1980 Staggers Rail Act. NCA supported the Act as signed into law in October of 1980. However, our support obviously was predicated on a notion that the regulatory process administered by the Interstate Commerce Commission would comply with the provisions of the 1980 Act and would conform with the intent of the Congress as expressed in the legislative history leading toward passage of the legislation.

Unfortunately, the Commission has failed to do so in several instances following enactment of the legislation. We are surprised and shaken by the Commission's failure, and now believe that Congress must furnish legislative guidance to the Commission in order to assure that the 1980 Act is implemented as intended. Therefore, the coal industry, joined by the electric utility industry, the mineworkers, and many other industries which rely on reasonably priced railroad transportation urge passage of bills pending in the Senate (S.1082) and in the House (H.R. 2584).

The 1980 Act has brought benefits in some areas, notably where rail carriers and shippers have been successful in negotiating long term contracts for specific railroad movements as first allowed under the 1980 Act. However, the comprehensive goals and related policy provisions of the 1980 Act are seriously undermined by the Commission's failure to provide a regulatory process that balances the needs of carriers, shippers, and the public, as required in the goals expressed in Section 3 of Public Law 96-448, the Staggers Rail Act of 1980.

This failure is underscored by the Commission's cavalier disregard of a key mandate expressed in Section 10101(a), Subtitle IV, Title 49, United States Code, the Interstate Commerce Act, as amended by the 1980 Act that in regulating the railroad industry, it is the policy of the United States Government . . . . . to maintain reasonable rates where there is an absence of effective competition.

Today America's coal and coal transportation network are well positioned to secure a full share of domestic and international energy markets in the 1980s, 1990s, and beyond. The possibilities are great by virtue of our abundant coal reserves, our capacity for producing greatly increased amounts of coal, and capabilities of rail and water carriers to furnish reliable and efficient coal transportation services. From these perspectives, the future is bright. Yet, there is a counterproductive cloud of uncertainty in this bright future, namely, whether railroad coal transportation rates will raise coal's delivered price so high as to lose an appreciable portion of coal's potential share of energy markets.

Coal prices at the mine are stable and coal-carrying railroads are in a strong financial position. The unfortunate uncertainty as to whether America's coal will reach its full potential in energy markets lies in the unwillingness of the Commission to implement the 1980 Act in a balanced manner.

Mr. Chairman, I have attached a chart identified as Exhibit A to my testimony to show that coal prices at the mine are stable. During the previous four years, mine prices of coal increased only one-half as much as the increase in the Bureau of Labor Statistics' Producer Price Index for all commodities. However, as shown on a second chart labeled Exhibit B, in the same four years railroad coal traffic rates increased one and one-half times as much as the increase in the BLS Producer Price Index. This amounts to a three-to-one comparison of increases in rail rates in relation to mine prices of coal, and is a clear signal that railroad coal traffic rates are climbing at an alarming pace.

Coal-carrying railroads are financially sound. In 1981, average rates of return on equity of coal-carrying railroads were 11.25 percent. Furthermore, under new methods of financial reporting established by the ICC, these rates should be raised by a factor of about 1.2 times. Thus, the rates of return on equity, if stated using the newly adopted reporting methods, were about the same as for manufacturing as a whole, which amounted to about 13.60 percent in 1981. Moreover, to underscore their financial strength, since 1980 the railroad's internal cash flow has been adequate to meet, and to exceed, capital expenditures attributable to the delivery of railroad transportation services.

Mr. Chairman, a sound railroad industry is important; therefore, we supported the 1980 Staggers Rail Act. We did so because the Act: (a) preserved a reasonable degree of captive shipper protection; (b) authorized the use of railroad transportation contracts; (c) improved railroad pricing flexibility to furnish adequate railroad revenues and provide good financial strength across the rail industry; (d) enabled railroads to reduce costs of providing transportation services; and (e) eliminated certain unnecessary and excessive regulation of the railroad industry.

Railroad revenues have been enhanced significantly by the Act's creation of a cost recovery index adjusted quarterly to account for inflation, establishment of a zone of rate flexibility allowing rail rates to be increased above inflation each year in specified percentages, and encouragement of railroad transportation contracts which assure revenues over certain time periods in re~~lationship~~ to prescribed rates for movements covered by contractual agreements. Furthermore, under the Act, movements are not under Commission jurisdiction with regard to rate reasonableness unless the rates exceed the variable costs of providing services by specified threshold percentages, representing a substantial reduction in rate regulation.

As expressed in a May 25 letter to the President signed by 27 chief executive officers of major coal companies who previously supported the 1980 Act, "implementation of the law by the ICC has ignored captive shipper protection to such an extent that the desirability of reduced regulation of the railroads is now open to serious question." The coal company chief executive officers have urged the President "to appoint to vacant positions on the Interstate Commerce Commission individuals who will recognize, as Congress did by passing the Staggers Rail Act, that adequate protection for captive shippers must be continued and that reduced regulation of the railroads is feasible only where sufficient competition exists to ensure reasonable rates."

With difficulties created by the Commission after the 1980 Act in mind, in April H.R. 2584 was introduced in the House of Representatives and S.1082 was introduced in the Senate. These bills would require the Commission to adhere to the comprehensive goals, policies, and provisions of the 1980 Act with regard to railroad ratemaking. Both of the bills define railroad market dominance in the Interstate Commerce Act, prohibit the Commission from exempting market dominant railroad traffic from regulation, and provide the Commission with guidelines for standards in regard to maximum rail rates and the determination of railroad revenue adequacy. We believe that passage of this legislation is essential to assure sound implementation of the 1980 Act.

The thrust of the legislation is to restore in the regulatory process the balance furnished in the 1980 Act, particularly to see that captive shipper protection against rail rate abuses will not be eroded through unwarranted, de facto total deregulation of market dominant traffic through regulatory exemptions and adoption of new standards for rail rates and revenues designed to encourage railroads to charge excessively high prices for services required by captive shippers.

The Commission has demonstrated that, without action of the Congress, the Commission will eliminate captive shipper protection in several ways: (a) by making it virtually impossible for shippers to show the existence of railroad market dominance in a timely fashion; (b) by adopting standards for rail rates and railroad revenue adequacy that impose "bounties" on captive traffic, especially coal traffic; and (c) by granting exemptions from regulation with regard to coal movements which are captive to the railroads, having no effective transportation alternative available.

There are several areas in which the Commission's failure to protect captive coal shippers is most evident. These focus on determination of railroad market dominance, railroad exemption of export coal traffic, railroad coal rate guidelines, and disregard of the Long-Cannon amendment.

In July 1981, in Ex Parte No. 320 (Sub-No. 2), seven months after the Act was signed into law, the ICC changed the rules for determining railroad market dominance, a decision which seriously erodes captive shipper protection by injecting the question of geographic and product competition into evidence as to the existence of market dominance in transportation. Whether a shipper could obtain a commodity from a different source or could substitute a different commodity for the freight at issue simply has no bearing on whether there is effective competition for the transportation of commodities between traffic originations and destinations such as mines and utility and industrial plants and ports engaged in transshipments from rail to water carriers.

The question of railroad market dominance is concerned with whether transportation competition exists for moving the same commodity from the same origin to the same destination, not, as the Commission has decided in Ex Parte No. 320 (Sub-No. 2), whether optional sources or substitutes could be selected for the commodity in question.

Last month, in Ex Parte No. 346 (Sub-No. 7), the Commission decided, effective September 12, 1983, to exempt, or to deregulate, export coal traffic. Such traffic is widely captive to the railroads for movement to deep draft ports for transshipment by ocean vessels and to shallow draft river ports for transshipment by inland water carriers. This recent action of the Commission directly circumvents captive shipper protection provided in the Interstate Commerce Act.

In February the Commission proposed railroad coal rate guidelines in Ex Parte No. 347 (Sub-No. 1) which endorse excessive increases in railroad coal traffic rates. The Commission proposes to allow coal rate increases of 15 percent per year above inflation, an arbitrary and wholly unacceptable "bounty" imposed on captive coal traffic.

Mr. Chairman, I have appended Exhibit C to my testimony to illustrate the gravity of this proposal. The Commission's proposal to phase-in rate increases on captive coal traffic, together with an estimated annual inflation rate of five percent, would result in over a fourfold increase in railroad coal rates between 1983 and 1990. A $10.00 per ton rate would be increased to $45.20 per ton. Increases of this magnitude raise grave concern about the inconsistency of the Commission's proposals in light of the nation's energy policy. Our energy policy clearly calls for use of America's coal and less dependence upon foreign oil, but this is in jeopardy if coal's delivered price becomes substantially higher due to excessively high rail rates for coal movements.

Coal rates already have increased 53 percent in four years. They could double in another four to five years under this proposed scheme. The proposal exceeds by far the rate flexibility provisions of the 1980 Act, which permitted rates to be increased up to six percent per year above inflation, not to exceed 18 percent in four years following enactment. Thereafter, an additional four percent per year can be imposed until any rail carrier which is not already revenue adequate becomes revenue adequate.

Therein lies another problem. The Commission utilizes a rate of return equated to the current cost of capital, without any rationalization of the railroad rate base, as a single criterion for measuring revenue adequacy. This should not represent the sole criterion for judging whether a railroad has adequate revenues. Other indicators of financial strength also should be examined and the calculation of return should be based only on investments which are used and useful in providing transportation services, depreciated to present value utilizing commonly accepted, uniform accounting practices and principles. Otherwise, even though in reality a railroad has adequate revenues to maintain financial soundness, blind adherence to a target rate of return calculated using a grossly overstated rate base will lead the Commission to forever judge the railroads to be revenue inadequate.

Perhaps one of the most noteworthy of the instances in which the Commission is not responsive to the Congress is the Commission's lack of interest in fulfilling the mandate embodied in the Long-Cannon amendment in the 1980 Act. The Commission casually disregards this important provision, which requires that the Commission consider certain factors in the course of determining whether a rate is reasonable, including:

- the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;
- the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and
- the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

One of the particularly telling instances of the Commission's insensitivity to the needs of captive coal shippers is highlighted by views of the House and Senate Conferees in their joint explanatory statement on the 1980 Act. The conferees stated that the rail transportation policy set forth in the Act is to encourage and promote the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition. Our studies show that 85 percent of coal carried by the railroads lacks any effective competition for the traffic. Thus, the circumstances I have cited clearly show that the Commission has seen fit to implement the 1980 Act without regard to rate abuses faced by captive traffic and in constant pursuit of total deregulation of captive traffic, notwithstanding the provisions of the Act intended to protect captive shippers.

Railroad rate abuses faced by captive coal shippers due to inadequate implementation of regulatory protection furnished in the law on the part of the Commission stands to cause declines in utilization of America's coal by 1985, 1990, and 1995, if the Commission fails to reverse its course. Recent evidence is presented in a soon to be published report of the Energy Information Administration, U.S. Department of Energy, entitled "Railroad Deregulation: Impact on Coal". The report summary notes that "higher rail transportation rates have a sizeable impact on U.S. coal production and consumption." The summary reveals that an analysis of the Commission's recent actions with regard to railroad coal rate guidelines and revenue adequacy, as well as deregulation of export coal traffic, indicates that, if no corrective action is taken, coal production would decline by 2.3 percent from base case projections in 1985, 5.0 percent in 1990, and 5.4 percent in 1995. Western coal production would be especially affected reflecting longer distances for western coal movements, with declines in production of 7.4 percent in 1985, 15.2 percent in 1990, and 13.3 percent in 1995, compared with base case projections in each year.

Certainly, Mr. Chairman, it must be quite evident that immediate measures are called for to bring the balance among needs of carriers, shippers, and the public called for in the 1980 Act to fruition in the regulatory process. We believe that this can be accomplished through a threefold combination of strategies. First, the pending legislation, S.1082 and H.R. 2584, should receive prompt consideration to correct inequities now faced by shippers captive to railroads. Second, extra care must be given to nominations for vacant seats on the Commission, placing special attention to the experience, objectivity, and impartiality of persons nominated with respect to treatment of carriers, shippers, and the public. Third, the Congress, through oversight committees, should hold hearings each year at which all of the commissioners join Members of the Congress, rail carriers, shippers, consumers, and other interests in examining how well the provisions of the Interstate Commerce Act are working in relationship to the soundness of the rail industry and the delivery of fair and equitable railroad transportation services by rail carriers for all railroad traffic.

In conclusion, Mr. Chairman, we believe that railroads always will have an important role in our nation's multi-modal freight transportation network. Railroads will continue to provide vital transportation services essential to our nation's commerce and industry and the likelihood of full utilization of our abundant and secure energy resource, coal. We urge this committee to quickly implement the concerted threefold approach that I have just outlined to avert serious problems and unfortunate losses due to inadequate implementation of the 1980 Staggers Rail Act in the regulatory process. I will be glad to respond to questions. Thank you for allowing me to appear before you on behalf of the National Coal Association.

* * * * *

attachments: Exhibits A, B and C.

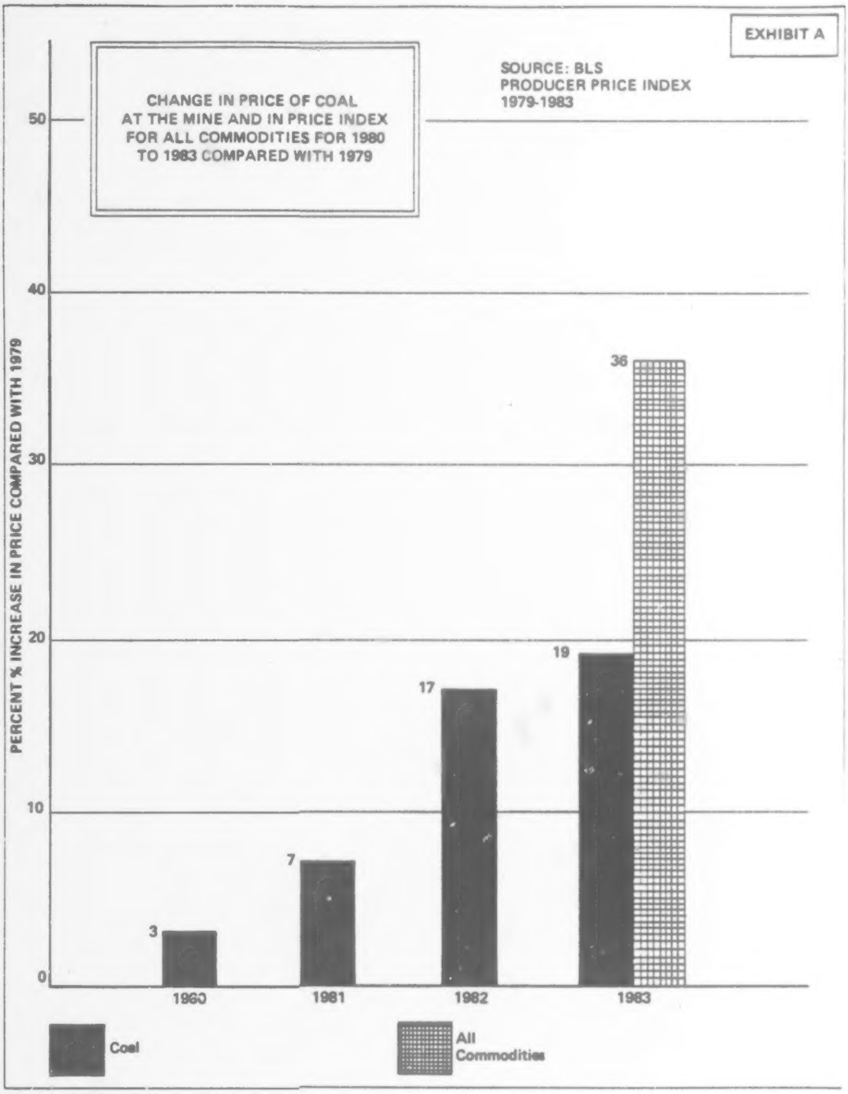


EXHIBIT A

CHANGE IN PRICE OF COAL
AT THE MINE AND IN PRICE INDEX
FOR ALL COMMODITIES FOR 1980
TO 1983 COMPARED WITH 1979

SOURCE: BLS
PRODUCER PRICE INDEX
1979-1983

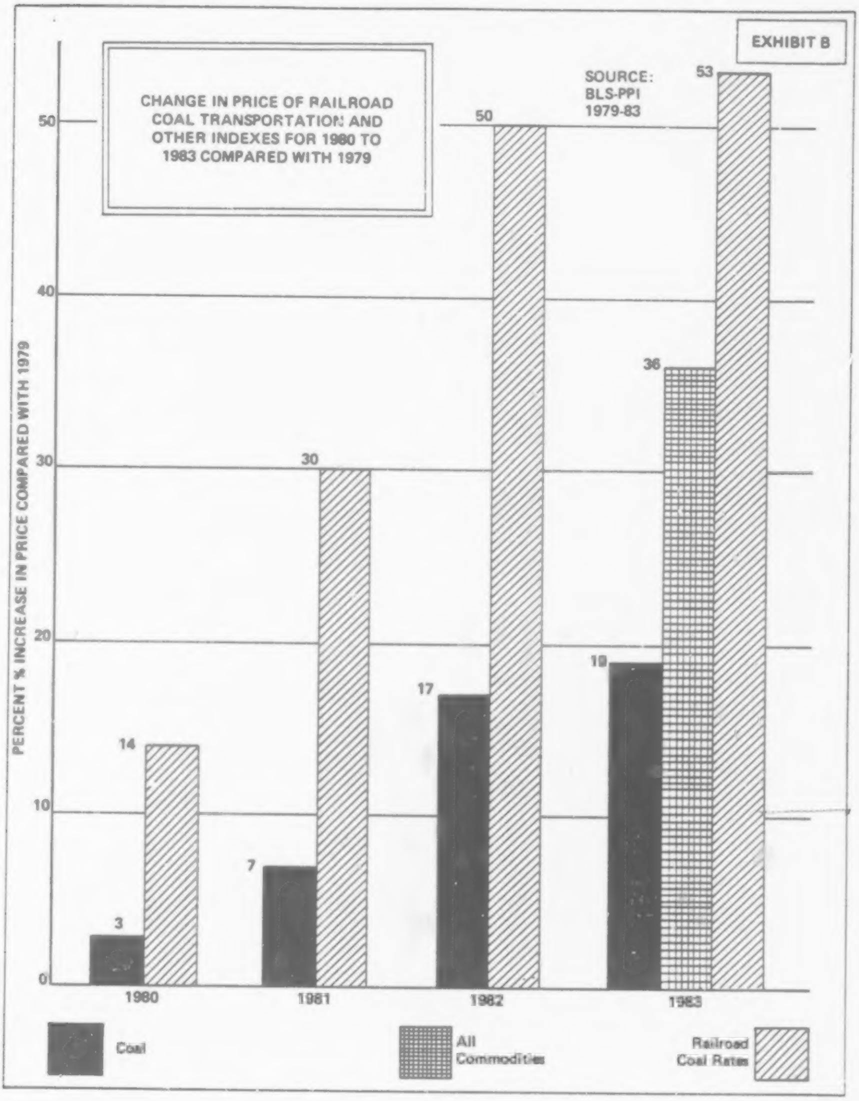


EXHIBIT B

CHANGE IN PRICE OF RAILROAD COAL TRANSPORTATION AND OTHER INDEXES FOR 1980 TO 1983 COMPARED WITH 1979

SOURCE: BLS-PPI 1979-83

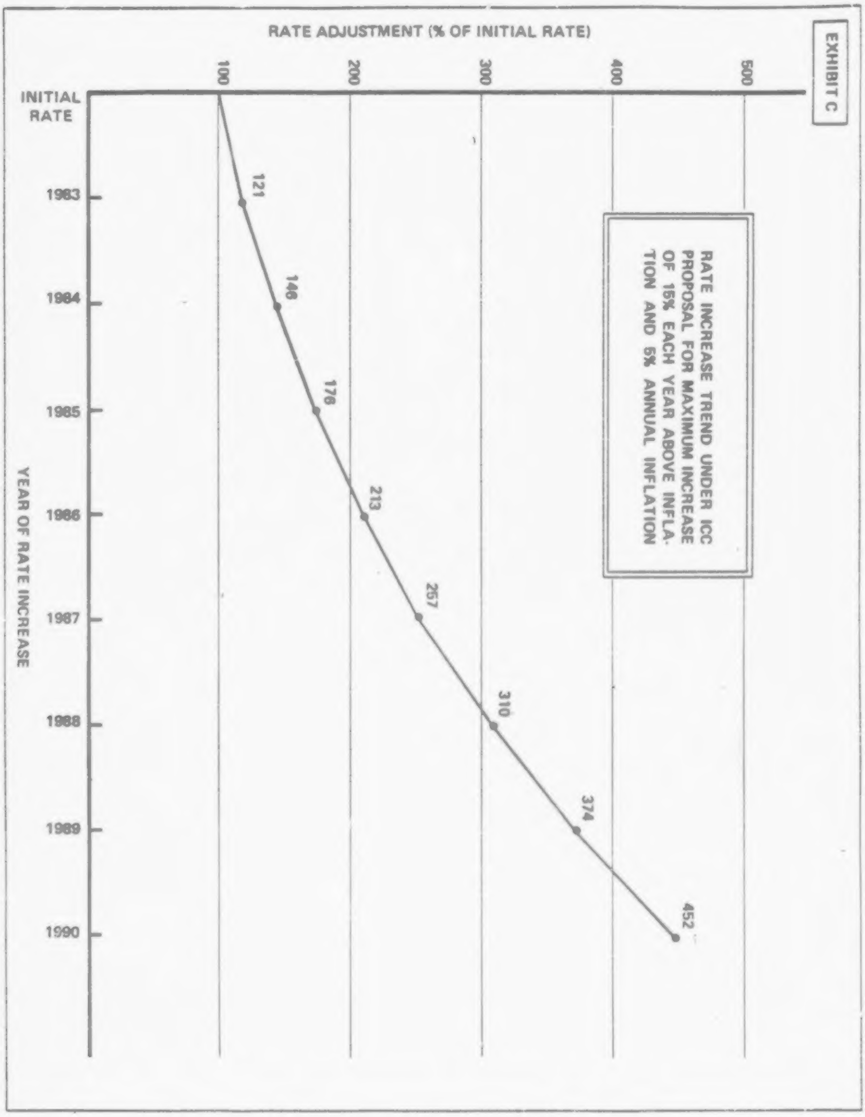


EXHIBIT C

RATE INCREASE TREND UNDER ICC PROPOSAL FOR MAXIMUM INCREASE OF 15% EACH YEAR ABOVE INFLATION AND 5% ANNUAL INFLATION

Senator **Warner**. Just a general observation—passing more laws, implementing more regulations to adjust inequities, were tried in the Staggers Act. Apparently it didn't work. We don't know that another set of laws along the line will correct the problem anymore than the Staggers Act seems to have done.

What puzzles me is why the marketplace hasn't been a more controlling factor here.

Do you concur in my observation that a substantial part of the rolling stock of the rail system are idle?

Mr. **Massey**. Yes, sir.

Senator **Warner**. And I am sure that in your travels in our capital you have had occasion to meet some of the senior executives in the rail system.

Mr. **Massey**. Yes, sir.

Senator **Warner**. In your travels in Roanoke—which we have a great deal of pride in that location in our State—do you occasionally discuss with them informally this situation with respect to how market factors aren't trying to correct this?

I find it difficult to think that they would put working rail personnel and rolling stock idle just to keep the transportation cost of coal high.

Mr. **Massey**. Well, that is true. All of those things are idle, but the railroad profits are still very healthy.

Senator **Ford**. Accelerated depreciation.

Senator **Warner**. Yes. We will get into it. All right, sir.

Mr. **Massey**. The profits are down somewhat on the railroads, I believe, but still they are very healthy compared to all of the rest of us in the industry, and it is true and I am sure the railroads make a point, that these rates have not increased over the last year or so. They have leveled off and we are wondering whether that occurred because of this legislation which Congressman Rahall has entered this year or last year. I am not exactly sure when that came out, or whether the railroads finally had realized that they milked the cow dry.

Senator **Warner**. How do the U.S. production costs of coal compare with your international competitors who are taking away our export coal market?

Mr. **Massey**. I think the production cost of U.S. coal is not the lowest cost in the world. The laborers in our mine fields are well paid. Our coal seams are not as thick as they are in other parts of the world, and for that reason we need the lowest possible transportation cost and the most efficiency that we can generate at our mines to be competitive.

The other side of that coin is that we have the best quality coal in the world perhaps with the exception of Poland and that is the reason why, though we have lost coal sales business, we are still able to hang in the export coal market. We have lost this business only after several years of these customers taking much higher priced coal.

They want to burn American coal, believe me.

Senator **Warner**. The testimony today will show that the decision to deregulate coal export rates has been in effect for only a very short period of time, and the ICC in its testimony will assure the subcommittee that should problems arise, the Commission stands ready to reassess the decision.

Do you know of any current facts or have any evidence of harmful effects of the decisions that have come out for the ICC to reopen its decision at this time? Your testimony covers that. I want that question in the record.

Mr. JOSEPH. Mr. Chairman, Senator Ford, Senator Hecht, I think that the problem is that if you wait for something to happen, it is already too late. The barn door has been open for a couple of years and all the horses are gone.

What really is important is the preception of overseas buyers as to what will happen.

If you will recall, before the oil crises, 90 percent of U.S. coal exports, or 95 percent, were metallurgical coal. This is the bedrock of our export business. The steam coal market, which holds or until recently held great promise perhaps someday will exceed our met coal business, but right now it doesn't look like it will over the short term, and when you run a steel plant on coal obtained abroad you are not using one type of coal. You are using a blend of coal that may be some American coal, some Australian, some German, some Polish, and it is that blend which gives us the type of coal that you want.

Once the buyers are convinced that there is uncertainty in the future of transportation costs in the United States, they will remove or reduce the amount of American coal from that blend and replace it with something else. Once it is replaced, they will make commitments for the replacement coal and that will be a lost market that we won't be able to get back, no matter what the ICC does, so the important thing for us at the present time is to reverse the preception of overseas buyers that there will be uncertainty in cost of transportation in the United States in the future.

Senator WARNER. My last question: One of the senior executives from one of the major railroad systems recently called for a blue-ribbon panel to be set up consisting of all of the interested parties to discuss and explore practical ways in which transportation costs for coal could be cut. Do you have any feeling as to whether a panel of that nature would be an adequate substitute for additional legislation?

Mr. JOSEPH. In words of one syllable, no; I think we are ready to sit down and talk with anybody at any time, but you don't need a blue-ribbon panel to see where the problem is, and the railroads have been very reluctant to discuss what the problem is and that is the level of rates.

Senator WARNER. Thank you. Senator Ford, would you like to continue with the questioning?

Senator FORD. Mr. Massey, you made a statement that one of our problems in export coal was the high cost to produce in comparison with other countries. The only thing we had going for us probably was quality in metallurgical coal.

Why should you expect the railroads to bear your inability to reduce your production costs?

Mr. MASSEY. Well, again, most of these customers are willing to buy our coal. We do not have to be on a parity with South Africa or Australia. They are willing to pay more for our coal.

Senator **Ford**. I understand it is a better quality. I understand that.

Mr. **Massey**. However, with the railroads going up and price going up and everything else coming down, that to them is not a show of good faith in American coal.

For instance, again to use the example of the electric utilities, they have told us that our prices of coal at f.o.b. to mine is acceptable. The quality is acceptable, and that they will continue the use of our coal in Denmark provided that they get a significant reduction in railroad rates.

Now they have not said that they had to be on a parity with the other countries of the world, but they have to recognize the fact that things are down, that the economy is down, and they need lower prices.

Senator **Ford**. You are aware probably of the efforts made to try to prevent American military installations from buying coal other than American coal in recent legislation. It appears that this administration is even going to turn its back on American producers, and allow foreign coal to be used on foreign installations that are solely American, so we are entering that problem, too.

I don't know whether you are aware or not, but I also have a little piece of legislation that talks about a deflator, and so with inflation coming down, we ought to be able to bring prices down a little bit somewhere along the way but apparently that is not happening, is it, Mr. Massey?

Mr. **Massey**. Well, it has happened in almost every industry except the railroad industry.

Senator **Ford**. I understand. It has not happened here in our testimony today. Do you think you will have any impact as it relates to the administration appointing somebody other than deregulators?

Mr. **Massey**. We are hoping so.

Senator **Ford**. I didn't say that. I mean faith without works is dead. Are you working on it a little bit?

Mr. **Massey**. We have suggested to the President some candidates that would certainly be acceptable to the coal industry.

Senator **Ford**. Well, I just wondered if you have a feeling of security that there might be a change in the philosophy of the Board?

Mr. **Massey**. Frankly, we do not.

Senator **Ford**. I understand that. It's a little tough. Now Mr. Joseph, I want to ask you one question and I don't want you to name names or anything, but it appears, was it Sweden or Switzerland where some 600,000-odd tons of coal was lost on an annual basis?

Mr. **Joseph**. You should ask that to Mr. Massey. It was his contract.

Senator **Ford**. It was in your testimony, though.

Mr. **Joseph**. Yes.

Senator **Ford**. I didn't know it was Mr. Massey. You didn't tell me.

Mr. **Joseph**. It was in Denmark.

Senator **Ford**. All right. Well, I was getting close, wasn't I? At least I was in that part of the world.

The railroads refused to adjust the railrates and we lost over 600,000 tons of coal in Denmark. Now without naming the railroad—I don't want you to do that. I think we all know—but how much would the rate, how much difference in the rate would there have to have been in order to continue the 680,000 tons of export?

Mr. JOSEPH. Of course, that is a question that could only be resolved in negotiation between the railroad and the buyer, but I am glad you asked the question because it relates really to a question that you asked Mr. Massey about the railroads bearing the burden of the decreasing world market price for coal.

One of the complaints that I hear frequently from overseas customers for steam coal, and I heard it particularly from this customer, was that they saw no reason why the railroads should engage in discriminatory pricing for coal which originates from the same mines, is shipped over the same tracks, dumped over the same pier, but is several dollars a ton cheaper when delivered to an American power station than when delivered to an overseas power station, and if the railroad is making a profit on coastwise business, they should be able to give the same rates to an overseas customer.

Senator FORD. What is the difference?

Mr. JOSEPH. I assume that is what they are aiming for in talking about a reduction of rates.

Senator FORD. All right. What if the total difference had come out of the rail rate? How much would that have been?

Mr. JOSEPH. Well, of course under the Staggers Act the contracts are made with a confidentiality provision and nobody is supposed to know what the rates are, but the coal industry being what it is, I would say that it is probably at about $4 a ton.

Senator FORD. So $4 a ton reduction in the rate?

Mr. JOSEPH. I think that's about what they would look for, but that is conjecture on my part.

Senator FORD. Well, you are here as an expert witness.

Mr. JOSEPH. That is expert conjecture.

Senator FORD. That's just as good as calling in an "honorable." I think I have all of it.

Senator WARNER. Senator Hecht.

Senator HECHT. That's a tough act to follow.

Senator FORD. But you haven't given me an offer for Las Vegas.

Senator HECHT. Your time will come. Just have patience.

Senator FORD. I hope so.

Senator WARNER. Gentlemen, let's proceed with the hearing. Thank you very much.

Senator HECHT. Mr. Joseph, just one question to you—I see you are with the Coal Exporters Association. Nevada is a great mining State, the State I represent.

I also serve on the Senate Banking Committee. We are having a lot of problems with our mining industry in Nevada because of the different international monetary fund loans to competing mining firms elsewhere that can compete far better than Nevada.

Are you having these same type of problems with the coal industry?

Mr. JOSEPH. Yes, sir; we do, to a limited extent. Certainly the loans that were granted, for example, to Columbia for mining equipment in the long run are not going to do the United States any good, particularly inasmuch as Columbian coal may be competive along the gulf and southeast coast of the United States itself for the coal business.

However, when we raised some objections or some questions to the loans we were told that the mining equipment machinery people needed business as much as we did, so it is really a question of whose objection is followed I guess.

Senator **Hecht**. Thank you very much; no further questions.

Senator **Warner**. We will now ask the other two panelists to provide their testimony.

Senator **Ford**. Let me ask Mr. Massey before he leaves, would you, Mr. Chairman, you talk about giving railroads competition, and that is coal slurry pipeline.

I oppose coal slurry pipeline, and probably should have been for it being from a coal producing State, but I could not see where coal slurry would have helped our State one iota. It was going over or under or over the mountains and never stopped, and so with eminent domain, seeing it go down through those beautiful blue grass farms in central Kentucky, we are not going to do that. I agree that there ought to be some competition, but I just wondered if there is some other way other than coal slurry pipelines. You've environmental problems. You've got underground water, agricultural water. You've the use of water at the end of the line. You've all these problems that I see and then Kentucky, the largest coal producer in the country, being bypassed by a line and not helping the small operator in any way.

We forced it into the bill as it came out of this committee that some percentage of the pipeline would go to the so-called small operator, but it looks like that they would just be excluded.

Do you have any other recommendation other than the coal slurry pipeline that might give competition?

Mr. **Massey**. I don't know of any other form of transportation that can be as efficient or as low cost as the pipeline principle.

It is true that a lot of the technology and a lot of the answers in coal pipeline have to be found through the expenditure of massive amounts of engineering research, but again, people are not going to spend that money to solve those problems until they have the right to do it.

Senator **Ford**. The right of eminent domain is like a planning and zoning meeting in city hall, too.

Thank you, Mr. Chairman.

Senator **Warner**. Mr. Massey and Mr. Joseph, will you remain as members of the panel until the other two have completed, just in case additional questions are prompted?

We will now hear from Mr. Moore.

STATEMENT OF C.R. MOORE, PRESIDENT, GETTY MINERALS MARKETING, INC., LOS ANGELES, CA, AND PRESIDENT, WESTERN COAL EXPORT COUNCIL

Mr. **Moore**. Thank you, Mr. Chairman. I am president of Getty Minerals Marketing, a wholly owned subsidiary of Getty Oil Co.

I am also president of the Western Coal Export Council. My appearance today is to briefly state the views of the Western Coal

Export Council and my company on the impact of recent transportation legislation and regulatory actions on western coal export marketing and utilization.

The Western Coal Export Council was formed in 1982 to promote the objectives of the Western Coal Export Task Force which had been previously organized by the Western Governors Policy Office. The purpose of this task force was to bring coal producers, railroad companies, and west coast port developers and terminal operators together with Governors in an effort to foster long-term steam coal exports to the Pacific basin markets.

The current membership of our Council includes 16 coal producers, 5 port and terminal operators, and 5 railroad companies. The council is proud of its efforts and accomplishments in maintaining a positive relationship with the coal users in Japan, South Korea, and Taiwan and providing a vehicle to work effectively with Congress and other Federal agencies on trade issues affecting western coal markets, generating independent assessments and other information about market potential for U.S. steam coal and Pacific rim nations and establishing a beneficial relationship between business and government in the West.

This last October the council delegates carried out a trade mission to Japan, Korea, and Taiwan to promote western coal export interests. On the home front, the Western Coal Export Council has recently been active in presenting its message to various legislative and government representatives in Washington to further efforts to expand the western coal in the Far East, and we, of course, had the opportunity to visit with you, Senator, recently to tell you about our trade mission.

It is this sort of cooperative effort by the Coal Export Council that hopefully will pave the way for expanded coal trade with Pacific rim countries.

I would now like to turn to a brief discussion of the recent regulatory action affecting western coal export activity.

The proceeding that obviously has had the most attention from an export standpoint is Ex Parte 346 Sub No. 7, Railroad Exemption-Export Coal.

Getty stated its opposition to the proposed exemption in 1981 on behalf of its wholly owned subsidiary, Plateau Mining Co., located in Carbon County, UT. Plateau has been the leading western coal export shipper of steam coal to Japan, Korea, and Taiwan since the market developed in 1980, shipping approximately 2½ million tons to date out of a total western coal export volume of 10 million tons during the same period.

Our opposition was based on railroad market dominance over our Utah export coal shipments to the ports of Los Angeles and Long Beach. In the absence of any effective transportation competition, we believe some form of reasonable regulation might be necessary.

At the time of filing in opposition to the proposed exemption we felt it was premature for the Interstate Commerce Commission to take steps to exempt west coast export coal traffic from all economic regulation so soon after passage of the Staggers Act, and so early in the development of west coast export market. Subsequent to the close of filings in the exemption proceeding Getty was successful in negotiating transportation service agreements under the Staggers umbrella to govern our export rail movements.

Through these negotiations with our participating rail carriers, we became increasingly aware of the influence of the world coal market on the pricing ability of producers, railroads, and port terminal operators. From Getty's individual viewpoint, it became apparent we would be able to market coal in an environment without regulation of rail transportation. Thus our opposition to the Ex Parte 346 was no longer pursued.

There is no question that western coal export shippers are captive to only a few railroads, and there is no ease of entry into the marketplace to allow additional rail competition. Recent liberalized merger activity only appears to reduce rail shipping options. There is no waterway alternative to move coal to port terminal facilities in the West. Slurry pipelines offer no shipping potential in the near term, if ever. To move coal from western producing points by truck to port terminals over distances which may exceed 1,000 miles is not even worth mentioning.

All this being the case, Getty believes that western exporters, railroads, and port terminal operators must fully understand the sensitive world coal market to effectively compete. We view this approach as the only sensible avenue available to foster and maintain western coal exports to Pacific rim customers.

Getty, with the cooperation of our rail carriers, has pursued such an avenue in marketing our Utah export coal. Because of this, Getty has been able to freely negotiate rail transportation contracts that are tailored to deal with the competitive realities in the world coal market.

At this juncture I would like to offer Getty's comments concerning legislation and regulatory issues relative to western coal domestic markets.

Getty supports cooperation among captive coal shippers, users and railroads in resolving problems associated with the railroad ratemaking practices. This is obviously preferable to litigation.

In our estimation, the Staggers Rail Act of 1980, while being viewed as poor legislation by some, was a positive step. It appeared to offer opportunities for railroads to attract capital, to operate more freely in their business endeavors, become more efficient, and achieve revenue adequacy. At the same time, the Act retained Interstate Commerce Commission jurisdiction to protect captive shippers.

We feel that Congress has a legitimate concern in reviewing recent interpretations and rulings of the ICC if it is determined that the Commission has not carried out its responsibilities in a manner consistent with the language and intent of Congress in writing the Staggers Act. We are not convinced that more legislation will necessarily solve the problem. If the Commission is not found to be carrying out the intent of Congress, then Congress should exercise its oversight power to insist on compliance with the law.

As originally enacted, the Staggers Act appeared to offer some hope in freeing the industry from overregulation while at the same time affording the captive shippers and users some protection. As is too often the case, Government bureaucrats have taken a well-intended legislation and frustrated the intent of Congress by providing relief for primary carriers while at the same time frustrating the free market system by providing no protection for the shipper or the user.

My testimony in some ways presents both sides of it, yet beneath it hopefully lies the message that the free market system is a great economic system, but like other issues on dealing with international trade, it must not only be free. It must be fair to all parties. When some of the participants don't play fair, there must be procedures to obtain a proper balance.

In summary, it is Getty's position that the interests of both coal producers, users and railroads would best be served by moving away from an environment of legislation, regulation and litigation. The proper course should be one of good faith negotiation whereby all parties can be assured of equitable treatment.

Thank you, Senator.

[The prepared statement of Mr. Moore follows:]

STATEMENT OF
C. R. MOORE

PRESIDENT, GETTY MINERALS MARKETING, INC.
AND
PRESIDENT, WESTERN COAL EXPORT COUNCIL

BEFORE THE

UNITED STATES SENATE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES

WASHINGTON D.C.
NOVEMBER 15, 1983

My name is C. R. Moore. I am President of Getty Minerals Marketing, Inc., a wholly owned subsidiary of Getty Oil Company. I am also President of the Western Coal Export Council.

The purpose for my appearance here today is to briefly state the views of the Western Coal Export Council and my company on the impact of recent transportation legislation and regulatory actions on Western Coal Export marketing and utilization. In addition, I will address the issues of regulation and legislative activity as they pertain to Getty's domestic coal operations.

The Western Coal Export Council was formed in 1982 to promote the objectives of the Western Coal Export Task Force which was organized by the Western Governors Policy Office in October, 1980. The unique purpose of this task force was to bring coal producers, railroad companies and West Coast port developers and terminal operators together with governors of the western states in an effort to foster long-term, high volume steam coal exports to Pacific Basin markets. This task force, in conjunction with the Japan Coal Development Company, Taiwan Power Company, and Korea Electric Company conducted a study of coal chains which link Western U.S. mines with coal users in Japan, South Korea, and Taiwan. Upon completion of this study in 1982, the Western Coal Export Council was formed to promote the exportation of western coal to overseas markets, especially those markets in the Pacific Basin. The current membership of the Council includes 16 coal producers, five port and terminal operators, and five railroad companies. The railroad membership is represented by The Atchison, Topeka and Santa Fe Railway Company, the Burlington Northern Railroad Company, the Denver and Rio Grande Western Railroad, the Southern Pacific Transportation Company, and the Union Pacific Railroad/Missouri Pacific Railroad.

The Western Coal Export Council is proud of its efforts and accomplishments in:

- Maintaining a positive relationship with coal users in Japan, South Korea, and the Republic of China.

- Providing a vehicle to work effectively with Congress and other federal agencies on trade issues affecting western coal markets.

- Generating independent assessments and other information about market potential for U.S. steam coal in Pacific Rim nations.

- Establishing a beneficial relationship between business and government in the West.

As recently as October of this year, Western Coal Export Council delegates carried out a trade mission to Japan, Korea, and Taiwan to promote Western coal export interests. On the home-front, the Western Coal Export Council has recently been active in presenting its message to various legislative and governmental representatives in Washington to further efforts to expand the role of Western coal in the Far East. As a follow-up to its Washington mission, the Council sent a letter to President Reagan outlining the group's purpose and detailing suggestions to enhance Western coal exports for the President's recent visit to Japan and Korea.

It is this sort of cooperative effort by the Western Coal Export Council that, hopefully, will pave the way for expanded coal trade with Pacific Rim countries.

I would now like to turn to a brief discussion of the recent regulatory action affecting Western coal export activity.

The proceeding that obviously has had the most attention from an export standpoint is Ex Parte 346 (Sub. No. 7), Railroad Exemption-Export Coal.

Getty stated its opposition to the proposed exemption in 1981 on behalf of its wholly owned subsidiary, Plateau Mining Company, located in Carbon County, Utah. Plateau, the leading western coal export shipper of steam coal to Japan, Korea, and Taiwan since the market developed in 1980, shipped approximately 2.5 million tons to date out of a total Western coal export volume of approximately 10 million tons shipped during that period. Our opposition was based on railroad market dominance over our Utah export coal shipments to Ports of Los Angeles and Long Beach. In the absence of any effective transportation competition, we believed some form of reasonable regulation might be necessary.

At the time of filing in opposition to the proposed exemption, we felt it was premature for the Interstate Commerce Commission to take steps to exempt West Coast export coal traffic from all economic regulation so soon after passage of the Staggers Act, and so early in the development of the West Coast

EXPORT MARKET. SUBSEQUENT TO THE CLOSE OF FILINGS IN THE EXEMPTION PROCEEDING, WE WERE SUCCESSFUL IN NEGOTIATING TRANSPORTATION SERVICE AGREEMENTS UNDER THE STAGGERS UMBRELLA TO GOVERN OUR EXPORT RAIL MOVEMENTS. THROUGH THESE NEGOTIATIONS WITH OUR PARTICIPATING RAIL CARRIERS, WE BECAME INCREASINGLY AWARE OF THE INFLUENCE OF THE WORLD COAL MARKET ON THE PRICING ABILITIES OF PRODUCERS, RAILROADS AND PORT TERMINAL OPERATORS. IN SHORT, FROM GETTY'S INDIVIDUAL VIEWPOINT, IT BECAME APPARENT THAT WE WOULD BE ABLE TO MARKET COAL IN AN ENVIRONMENT WITHOUT REGULATION OF RAIL TRANSPORTATION. THUS, OUR OPPOSITION TO THE EX PARTE 346 PROPOSAL WAS NO LONGER PURSUED, AS WE FELT WORLD MARKET FACTORS WOULD ACT TO INFLUENCE RAIL PRICING POLICY, IN LIEU OF ECONOMIC REGULATION BY THE ICC.

THERE IS NO QUESTION THAT WESTERN COAL EXPORT SHIPPERS ARE CAPTIVE TO ONLY A FEW RAILROADS. THERE IS NO EASE OF ENTRY INTO THE MARKETPLACE TO ALLOW ADDITIONAL RAIL COMPETITION. RATHER, RECENT LIBERALIZED MERGER ACTIVITY ONLY APPEARS TO REDUCE RAIL SHIPPING OPTIONS. THERE IS NO WATERWAY ALTERNATIVE TO MOVE COAL TO PORT TERMINAL FACILITIES IN THE WEST. SLURRY PIPELINES OFFER NO SHIPPING POTENTIAL IN THE NEAR TERM - IF EVER. TO MOVE COAL FROM WESTERN PRODUCING POINTS BY TRUCK TO PORT TERMINALS OVER DISTANCES WHICH MAY EXCEED 1000 MILES IS NOT EVEN WORTH MENTIONING.

ALL THIS BEING THE CASE, GETTY BELIEVES THAT WESTERN EXPORTERS, RAILROADS, AND PORT TERMINAL OPERATORS MUST FULLY UNDERSTAND THE SENSITIVE WORLD COAL MARKET TO EFFECTIVELY COMPETE.

WE VIEW THIS APPROACH AS THE ONLY SENSIBLE AVENUE AVAILABLE TO FOSTER AND MAINTAIN WESTERN COAL EXPORTS TO PACIFIC RIM CUSTOMERS. GETTY, WITH THE COOPERATION OF OUR SERVING RAIL CARRIERS, HAS PURSUED SUCH AN AVENUE IN MARKETING OUR UTAH EXPORT COAL. BECAUSE OF THIS GETTY HAS BEEN ABLE TO FREELY NEGOTIATE RAIL TRANSPORTATION CONTRACTS THAT ARE TAILORED TO DEAL WITH THE COMPETITIVE REALITIES IN THE WORLD COAL MARKET. THUS, WE HAVE BEEN ABLE TO MARKET COAL TO PACIFIC RIM CUSTOMERS DESPITE SOFT DEMAND AND SEVERELY DEPRESSED PRICES. IT IS OUR INTENT TO CONTINUE THIS COOPERATIVE MARKETING STRATEGY WITH OUR PARTICIPATING RAIL CARRIERS.

AT THIS JUNCTURE, I WOULD LIKE TO OFFER GETTY'S COMMENTS CONCERNING LEGISLATIVE AND REGULATORY ISSUES RELATIVE TO WESTERN COAL DOMESTIC MARKETS. GETTY SUPPORTS COOPERATION AMONG CAPTIVE COAL SHIPPERS, USERS, AND RAILROADS IN RESOLVING PROBLEMS ASSOCIATED WITH RAILROAD RATEMAKING PRACTICES. THIS IS OBVIOUSLY PREFERABLE TO LITIGATION.

IN OUR ESTIMATION, THE STAGGERS RAIL ACT OF 1980, WHILE BEING VIEWED AS POOR LEGISLATION BY MANY COAL INTERESTS, WAS A POSITIVE STEP.

IT APPEARED TO OFFER OPPORTUNITIES FOR RAILROADS TO ATTRACT CAPITAL, TO OPERATE MORE FREELY IN THEIR BUSINESS ENDEAVORS, BECOME MORE EFFICIENT, AND ACHIEVE REVENUE ADEQUACY. AT THE SAME TIME, THE ACT RETAINED INTERSTATE COMMERCE COMMISSION JURISDICTION TO PROTECT CAPTIVE SHIPPERS.

WE FEEL THAT CONGRESS HAS A LEGITIMATE CONCERN IN REVIEWING RECENT INTERPRETATIONS AND RULINGS OF THE INTERSTATE COMMERCE COMMISSION IF IT IS DETERMINED THAT THE COMMISSION HAS NOT CARRIED OUT ITS RESPONSIBILITIES IN A MANNER CONSISTENT WITH THE LANGUAGE AND INTENT OF CONGRESS IN WRITING THE STAGGERS ACT. THEREFORE, WE ARE NOT CONVINCED THAT MORE LEGISLATION IS WARRANTED UNDER THE CIRCUMSTANCES. IF THE COMMISSION IS FOUND NOT TO BE CARRYING OUT THE INTENT OF CONGRESS, THEN CONGRESS SHOULD EXERCISE ITS OVERSIGHT POWER TO INSIST UPON COMPLIANCE WITH THE LAW.

IN SUMMARY, IT IS GETTY'S POSITION THAT THE INTERESTS OF COAL PRODUCERS, USERS, AND RAILROADS WOULD BEST BE SERVED BY MOVING AWAY FROM AN ENVIRONMENT OF LEGISLATION, REGULATION, AND LITIGATION. THE PROPER COURSE SHOULD BE ONE OF GOOD FAITH NEGOTIATION WHEREBY ALL THE PARTIES CAN BE ASSURED OF EQUITABLE TREATMENT.

Senator **WARNER**. Thank you, Mr. Moore.
Mr. Altmeyer.

STATEMENT OF THOMAS ALTMEYER, VICE PRESIDENT, GOVERNMENT AFFAIRS, MINING & RECLAMATION COUNCIL OF AMERICA, WASHINGTON, DC

Mr. **ALTMEYER**. Mr. Chairman, I am Thomas Altmeyer, vice president of Government Affairs for the Mining & Reclamation Council of America [MARC].

I appear today on behalf of MARC's members from all coal producing regions of our country. We have submitted a statement for the record, Mr. Chairman. I will briefly summarize my remarks.

I did want to add the Virginia Mining and Reclamation Association, a MARC affiliate, was unable to appear today but has asked me to let you all know that they will be submitting comments for the record in your hearing and appreciate your interest, Senator.

Approximately 10 years ago, Mr. Chairman, members of the committee, as a result of international political events, several Mideastern nations embargoed the movement of oil from that region to selected markets throughout the world. This economically destabilizing event precipitated over a tenfold increase in the world price of oil over the subsequent 7 years.

The U.S. response to that crisis was in large part engineered in this committee hearing room and coordinated by the past three administrations with other nations through international cooperative bodies. The United States has endeavored to assure the world that coal could be relied upon as a reliable and financially stable energy feedstock. The goal of the program was to create economic and political stability through providing certainty in energy markets, that is, to reduce the risk associated with fuel utilization choices both here and abroad.

The risk of a repeat of the events of the mid-1970's is substantially less today as a result of those efforts. However, we must not be lulled into a sense of security. The continuing political instability of the Mideast and presence of American Armed Forces in Lebanon are strong testimony to the continuing volatility of the world's major oil production region.

The effort to promote coal as a reliable and financially stable energy feedstock for both domestic and international markets has been potentially jeopardized by several decisions of the ICC as outlined by the other witnesses on the panel, and the escalation of rail rates for coal movements over the past several years. An unacceptable level of risk has been injected into the planning process which will impede progress toward the goals established by this committee in the national energy plan.

While rail rates and their potential for escalation are not the only factors impeding planning, utilities both here and overseas are acutely alarmed because rail rates are the only link in the fuel procurement chain which is not price constrained by competition. Their anxiety has been exacerbated by the proposed abrogation of regulatory oversight and review by the ICC as reflected in its decisions on rail market dominance, railroad exemption, export coal, coal rate guidelines, and rail revenue adequacy.

The coal industry concerns were recently well expressed by the Secretary of Energy, Don Hodel, at a conference in South Carolina when he stated, and I quote:

> Frankly, from my point of view, we need some kind of legislation or some kind of provision—I don't know whether it is coal slurry or something else—which will cause the railroads to begin to be realistic with the rates they charge for transporting energy. They have a monopolistic position, and frankly they are gouging the consumers in the United States and rendering us incapable of expanding our markets in the international arena.

Secretary Hodel's remarks are, unfortunately, accurate. In a capitalistic economy, competition is relied upon to assure that goods and services are available at the most efficient price. Absent competition, regulatory oversight has been utilized to assure that prices reflect the cost of the service with a reasonable rate of return. Absent competition or regulatory oversight, a monopolist, as a railroad, will charge a rate which will maximize its return, and I must add in the interests of their shareholders, they should do no less.

The Staggers Rail Act was intended by Congress to provide revenue adequacy for the railroads, to reform railroad regulation to allow railroads greater flexibility in setting prices and reducing costs where transportation competition exists while continuing vital protection for captive shippers against abuses in rates and service arising from the exercise of monopoly power by the railroads.

The ICC has ignored the intent of Congress and failed to provide meaningful, balanced protection for captive shippers. Although it is too early to cite specific impacts of the ICC's abrogation of the captive shipper protections of the Staggers Act, the EIA report as outlined by Mr. Joseph certainly puts fear into the coal industry and into the allied industries, the allied industries of the coal industry, with respect to what the outcome of the ICC decisions will be.

I want to just translate briefly the proposed declines of the reductions in coal exports as a result of the ICC decisions and what it means in our balance of payments.

This reduction translates into reduced U.S. export revenues in 1981 dollars of approximately $750 million in 1985, and $1.3 billion in 1990. This policy is directly contrary to the national policy of expanding exports and is shocking when viewed in light of a projected balance of payments deficit for the United States this year of $35 billion.

I should also add that the EIA report projects reductions in coal production for domestic use as a result of the ICC decisions of 24 million tons in 1985 and 65 million tons in 1990. The EIA analysis clearly indicates that the ICC's implementation of the Staggers Act is inconsistent with the national energy policy developed over the past several years in this committee and will hinder the efforts of the United States and the world to reduce dependence on oil as an energy feedstock.

A particular concern of MARC arising from the ICC's decisions is the abrogation of captive shipper protections of the Staggers Act and the impact on smaller operators.

Although all coal producers have relatively little power in negotiating rates with a rail carrier, the smaller operator has no leverage whatsoever. Larger operators with long-term sales contracts and production levels and topographical features that permit utilization of unit trains are attractive customers to railroads seeking to sign a contract to secure a steady source of business over a number of years.

By contrast, the smaller operator generally is selling on the spot market and does not have sufficient capacity to utilize unit trains. As a consequence, he must accept whatever rate and service terms are prescribed by the carrier.

Prior to the recent ICC decisions, the smaller operator could file a complaint with the ICC if a rate was unreasonable or abusive. As a result of the ICC's decisions in rail market dominance and coal rate guidelines, that leverage which was a constraint on the railroads has been effectively taken away.

With respect to export coal rates, since September 12, 1983, there is no ICC review available at all. The smaller operator has two options—agree to the terms prescribed by the railroad, or don't ship the coal. The latter option is not viable for the smaller producer with limited operations.

Mr. Chairman, in conclusion MARC would like to make two recommendations for the committee's consideration.

First, for the reasons outlined in our submitted statement, MARC considers legislation necessary to assure that the ICC fulfills the balanced twin goals of the Staggers Act—elimination of unnecessary regulation and continuous protection to captive shippers.

Several of the critical issues that must be considered in such legislation are addressed in S. 1082 and H.R. 2584 introduced by Senator Ford and Representative Rahall. MARC membership supports these proposals and urges their prompt consideration and enactment.

Second, Mr. Chairman, recognizing that this committee does not have jurisdiction over the Staggers Rail Act changes but does have jurisdiction over energy policy, MARC recommends that the committee first hold specific hearings on the impact of rail deregulation on energy policy and prepare a report with recommendations to the Senate; second, urge the administration to fill the three vacancies at the ICC with nominees appreciative of the interrelationship between transportation policy and energy policy; and third, hold separate hearings on ICC nominees to review their qualifications and views on transportation and energy policy prior to their consideration in the Senate.

I did want to add two additional points, Mr. Chairman, in response to questions that were asked by yourself and Senator Ford.

The EEI recently—Edison Electric Institute—found from 1976 through 1981 rail rates for transporting coal have risen faster than the cost of providing the service. Rail coal rates in constant dollars over that 5-year period have increased by 40 percent. Coal prices at the mine, on the other hand, have declined by 18 percent in constant dollars since 1976.

One additional point with respect to why there are a great number of railroad employees on layoff, the president of the union of the Pacific Railroad at a meeting of the business council stated that 6,000 of his company's employees were on layoff. He said they would probably not come back to work for the railroad, and his explanation for this was simple, and I quote:

> We are running 40 percent more freight tonnage than we did 20 years ago with half as many employees. If we had the same number of employees we had then, we would have priced ourselves out of the market.

How have we done it? Automation. The coal industry supports the efforts and is the beneficiary of the efforts of the railroads to reduce unnecessary costs. It is helping to moderate the cost of shipment.

However, our basic concern is the railroads are in a monopolistic position and absent competition or regulatory oversight, they will do what any good corporation should do, which is maximize return to their shareholders.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Altmeyer follows:]

STATEMENT

MINING AND RECLAMATION COUNCIL OF AMERICA (MARC)

OVERSIGHT HEARINGS

IMPACT OF INTERSTATE COMMERCE COMMISSION

DECISIONS ON THE COAL INDUSTRY

ENERGY AND MINERAL RESOURCES SUBCOMMITTEE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

NOVEMBER 15, 1983

Mr. Chairman, I am Thomas Altmeyer, Vice President for Government Affairs of the Mining and Reclamation Council of America (MARC) and appear today on behalf of MARC's members from all coal producing regions of our country. MARC appreciates your continuing concern Mr. Chairman, as evidenced by this hearing and the series of hearings on the expanded use of coal, both in the United States and abroad, you have conducted.

Approximately 10 years ago, as a result of international political events, several mideastern nations embargoed the movement of oil from that region to selected markets throughout the world. This economically destabilizing event precipitated over a ten-fold increase in the world price of oil over the subsequent seven years. The economies of all oil importing countries are now finally adjusting to the new economic order the embargo and the subsequent oil cartel imposed on the world. The adjustment to date has been achieved through diversification of fuel supplies, implementation of conservation measures, and greater reliance on the world's most abundant and available fossil fuel - coal.

The U.S. response to the crisis was, in large part, engineered by this committee and coordinated by the past three Administrations with other nations through the OECD, the International Energy Agency, and other international cooperative bodies. The U.S., which has over one-quarter of the world's proven coal reserves, has endeavored to assure the world that coal could be relied upon as a reliable and financially stable energy feedstock. The program included several legislative initiatives enacted over that period culminating with the Energy Security Act in 1980. These measures provided the framework for moving toward energy independence.

THE EFFORT WAS DIRECTED TO REDUCING UNNECESSARY ENERGY USE, DEVELOPING ALTERNATIVE ENERGY SOURCES AND SUPPLIES, FOSTERING UTILIZATION OF FUELS FOR THEIR OPTIMUM USE, AND ENHANCING THE UTILIZATION OF MORE ABUNDANT FUELS AS COAL. THE GOAL OF THE PROGRAM WAS TO CREATE ECONOMIC AND POLITICAL STABILITY THROUGH PROVIDING CERTAINTY IN ENERGY MARKETS, I.E., TO REDUCE THE RISK ASSOCIATED WITH FUEL UTILIZATION BOTH HERE AND ABROAD.

THE RISK OF A REPEAT OF THE EVENTS OF THE MID-70'S IS SUBSTANTIALLY LESS TODAY AS A RESULT OF THESE EFFORTS. HOWEVER, WE MUST NOT BE LULLED INTO A SENSE OF SECURITY. THE CONTINUING POLITICAL INSTABILITY OF THE MIDEAST AND THE PRESENCE OF AMERICAN ARMED FORCES IN LEBANON ARE STRONG TESTIMONY TO THE CONTINUING VOLATILITY OF THE WORLD'S MAJOR OIL PRODUCING REGIONS.

WITH RESPECT TO COAL, THE EFFORTS TO PROVIDE A RELIABLE AND FINANCIALLY STABLE ENERGY FEEDSTOCK FOR DOMESTIC AND INTERNATIONAL MARKETS, HAVE BEEN POTENTIALLY JEOPARDIZED BY SEVERAL DECISIONS OF THE INTERSTATE COMMERCE COMMISSION'S (ICC) AND THE ESCALATION OF RAIL RATES FOR COAL MOVEMENT. THE GOAL OF PROVIDING CERTAINTY IN SUPPLY AND PRICE TO FACILITATE REASONED CAPITAL INVESTMENT PLANNING BY COAL USERS HAS BEEN SEVERELY ERODED BY THESE FACTORS OVER THE PAST SEVERAL YEARS. AS A CONSEQUENCE, AN UNACCEPTABLE LEVEL OF RISK HAS BEEN INJECTED INTO THE PLANNING PROCESS WHICH WILL IMPEDE PROGRESS TOWARD THE GOALS ESTABLISHED BY THIS COMMITTEE IN THE NATIONAL ENERGY PLAN.

WHILE RAIL RATES AND THEIR POTENTIAL FOR ESCALATION ARE NOT THE ONLY FACTORS IMPEDING PLANNING, UTILITIES BOTH HERE AND OVERSEAS ARE ACUTELY

ALARMED BECAUSE RAIL RATES ARE THE ONLY LINK IN THE FUEL PROCUREMENT CHAIN WHICH IS NOT PRICE CONSTRAINED BY COMPETITION. THEIR ANXIETY HAS BEEN EXACERBATED BY THE PROPOSED ABROGATION OF REGULATORY OVERSIGHT AND REVIEW BY THE ICC AS REFLECTED IN ITS DECISIONS ON MARKET DOMINANCE, RAILROAD EXEMPTION - EXPORT COAL, COAL RATE GUIDELINES, AND REVENUE ADEQUACY.

THE CONCERN OF THE COAL INDUSTRY WAS RECENTLY WELL EXPRESSED BY THE SECRETARY OF ENERGY, DON HODEL WHO STATED:

> "FRANKLY, FROM MY POINT OF VIEW, WE NEED SOME KIND OF LEGISLATION OR SOME KIND OF PROVISION - I DON'T KNOW WHETHER IT IS COAL-SLURRY OR SOMETHING ELSE - WHICH WILL CAUSE THE RAILROADS TO BEGIN TO BE REALISTIC WITH THE RATES THEY CHARGE FOR TRANSPORTING ENERGY.... THEY HAVE A MONOPOLISTIC POSITION AND FRANKLY THEY ARE GOUGING THE CONSUMERS IN THE UNITED STATES AND ARE RENDERING US INCAPABLE OF EXPANDING OUR MARKETS IN THE INTERNATIONAL ARENA."

SECRETARY HODEL'S REMARKS ARE, UNFORTUNATELY, ACCURATE. IN A CAPITALISTIC ECONOMY, COMPETITION IS RELIED UPON TO ASSURE THAT GOODS AND SERVICES ARE AVAILABLE AT THE MOST EFFICIENT PRICE. ABSENT COMPETITION, REGULATORY OVERSIGHT HAS BEEN UTILIZED TO ASSURE THAT PRICES REFLECT THE COST OF THE SERVICE WITH A REASONABLE RATE OF RETURN. ABSENT COMPETITION OR REGULATORY OVERSIGHT, A MONOPOLIST - AS A RAILROAD - WILL CHARGE A RATE WHICH WILL MAXIMIZE ITS RATE OF RETURN.

IN DOING SO, THE RAILROAD IS FULFILLING THE PRIMARY PURPOSE OF ANY CORPORATION - TO MAXIMIZE PROFITS AND THE RETURN TO ITS INVESTORS, THE

SHAREHOLDERS. IN THE ABSENCE OF COMPETITION OR REGULATORY OVERSIGHT, THEY ARE IN AN EXCELLENT POSITION TO DO SUCH AND, RIGHTFULLY, SHOULD BE EXPECTED TO DO NO LESS.

REGRETABLY THE COAL INDUSTRY IS NOT SO FORTUNATE. OVER 2500 COAL COMPANIES OPERATE IN THE UNITED STATES. THE 50 LARGEST COAL PRODUCERS ONLY ACCOUNT FOR ROUGHLY 50% OF THE NATION'S COAL PRODUCTION. HUNDREDS OF SMALLER OPERATORS ASSURE THAT NO COMPANY WILL BE WITHOUT COMPETITION. BY CONTRAST, 4 RAILROADS ACCOUNT FOR 82% OF ALL COAL MOVEMENTS BY RAIL IN THE UNITED STATES. NATIONALLY, APPROXIMATELY 70% OF COAL TRANSPORTATION IS BY RAIL. IN THE WEST 98% OF COAL PRODUCTION IS CAPTIVE TO RAIL FOR MOVEMENT. NATIONALLY, 85% OF COAL MOVEMENTS ARE CAPTIVE TO RAIL. FROM 1971 TO 1982 THE AMOUNT OF COAL FOR DOMESTIC USE AND EXPORT SHIPPED BY RAIL INCREASED FROM 360 TO 527 MILLION TONS. OVER THAT PERIOD, RAIL REVENUES FOR COAL MOVEMENTS ROSE 372% WHILE REVENUES FOR THE COAL INDUSTRY ADVANCED ONLY 85%.

IN SPITE OF THIS STRONG FINANCIAL SHOWING, THE ICC HAS FOUND ALL CLASS I RAIL CARRIERS TO BE REVENUE INADEQUATE AND HAVE USED THIS FINDING TO SUPPORT DECISIONS WHICH WILL PERMIT RAIL RATES TO CONTINUE INCREASING AT A RATE OF 15% ABOVE INFLATION THROUGH AT LEAST 1990. SEVERAL RECENT EVENTS CAUSE ONE TO SERIOUSLY QUESTION THE ICC'S FINDING OF FINANCIAL DISTRESS IN THE RAILROAD INDUSTRY.

- CSX PURCHASED TEXAS GAS RESOURCES CORPORATION, A MAJOR ENERGY DEVELOPMENT AND TRANSPORTATION COMPANY (WHICH INCLUDES THE SECOND LARGEST INLAND WATERWAY TRANSPORTER OF COAL), FOR $1.04 BILLION.

- Burlington Northern purchased the El Paso Company, a energy development and transportation company for approximately $700 million.
- Norfolk Southern increased its ownership of Piedmont Airlines from 8% to 20% for $57 million and purchased 5% of the Santa Fe Railroad. As a consequence of these relatively minor investments, the New York investment community has been demanding to know what the railroad plans to do with its $914 million cash balance.
- CONRAIL, while also profitable, has been content to be a railroad while it awaits a purchaser.

While this profile is only limited to the four major coal hauling railroads which control 82% of all rail movement of coal, it is reflective of the strong financial position of all coal hauling railroads.

A goal of the Staggers Act, which the coal industry supported, was to provide for the revenue adequacy of the railroads to assure a safe and reliable national rail transportation system. As evidenced by the above example, although all these carriers are revenue inadequate under ICC guidelines, to the public at large they are revenue adequate. It should also be noted that each of these carriers has made substantial investments in rail facilities resulting in significant improvements in rail service and reliability. Additionally, the capital expenditure plans of the railroads underscore their continuing commitment to reliable rail service for coal movement. The coal industry has, as a result, been a direct beneficiary of the Staggers Act.

However, in addition to revenue adequacy, the other major purpose of the Staggers Act was to provide continuing protection for captive shippers, as coal. The ICC has totally ignored this other mandate of the law.

The Staggers Rail Act was intended by Congress to reform railroad regulation allowing railroads greater flexibility in setting prices and reducing costs where transportation competition exists while continuing vital protection for captive shippers against abuses in rates and service arising from the exercise of monopoly power by the railroads. The Act also sought to promote rail-to-rail competition.

The ICC, in implementing the Staggers Act, has ignored the intent of Congress and failed to provide meaningful balanced protection for captive shippers. The Commission has authorized the total exemption of export coal from regulation and has allowed several major rail carriers to cancel joint rates and through routes, as well as reciprocal switching agreements, causing the elimination of intramodal rail competition -- also in contravention of Congressional intent.

Although it is too early to site specific impacts of the ICC's abrogation of the captive shipper protections of the Staggers Act, the Energy Information Agency (EIA) of the Energy Department in an August 1983 Report titled Railroad Deregulation: Impact on Coal did project that U.S. coal exports as a result of the ICC decision, will decrease from earlier projections by 15 million tons in 1985, 27 million tons in 1990, and 37 million tons in 1995. This reduction translates into reduced U.S. export

REVENUES IN 1981 DOLLARS OF APPROXIMATELY $750 MILLION IN '85, $1.35 BILLION IN '90, AND $1.85 BILLION IN 1995. THIS POLICY IS DIRECTLY CONTRARY TO THE NATIONAL POLICY OF EXPANDING EXPORTS AND IS SHOCKING WHEN VIEWED IN LIGHT OF A PROJECTED BALANCE OF PAYMENTS DEFICIT FOR THE U.S. THIS YEAR OF $35 BILLION.

THE EIA REPORT PROJECTS REDUCTIONS IN COAL PRODUCTION FOR DOMESTIC USE OF 24 MILLION TONS IN '85, 65 MILLION TONS IN '90, AND 66 MILLION TONS IN '95, AS A RESULT OF THE ICC'S DECISIONS.

THE EIA ANALYSIS CLEARLY INDICATES THAT THE ICC'S IMPLEMENTATION OF THE STAGGERS ACT IS INCONSISTENT WITH THE NATIONAL ENERGY POLICY DEVELOPED OVER THE PAST SEVERAL YEARS AND WILL HINDER THE EFFORTS OF THE U.S. AND THE WORLD TO REDUCE DEPENDENCE ON OIL AS AN ENERGY FEEDSTOCK.

A PARTICULAR CONCERN OF MARC ARISING FROM THE ICC'S ABROGATION OF THE CAPTIVE SHIPPER PROTECTIONS OF THE STAGGERS ACT IS THE IMPACT ON SMALLER OPERATORS. ALTHOUGH ALL COAL PRODUCERS HAVE RELATIVELY LITTLE POWER IN NEGOTIATING RATES WITH A RAIL CARRIER, THE SMALLER OPERATOR HAS NO LEVERAGE WHATSOEVER. LARGER OPERATORS, WITH LONG TERM SALES CONTRACTS AND PRODUCTION LEVELS AND TOPOGRAPHICAL FEATURES THAT PERMIT THE UTILIZATION OF UNIT TRAINS, ARE ATTRACTIVE CUSTOMERS TO RAILROADS SEEKING TO SIGN A CONTRACT TO SECURE A STEADY SOURCE OF BUSINESS OVER A NUMBER OF YEARS. BY CONTRAST, THE SMALLER OPERATOR GENERALLY IS SELLING ON THE SPOT MARKET AND DOES NOT HAVE SUFFICIENT CAPACITY TO UTILIZE UNIT TRAINS. AS A CONSEQUENCE, HE MUST ACCEPT WHATEVER RATE AND SERVICE TERMS ARE PRESCRIBED BY THE CARRIER SINCE HE HAS NO BASIS TO NEGOTIATE A CONTRACT.

Prior to the recent ICC decisions, the smaller operator could file a complaint with the ICC if a rate was unreasonable or abusive. As a result of the ICC's decisions in rail market dominance and coal rate guidelines, that leverage - which was a subtle constraint on the railroads - has been effectively taken away. With respect to export coal rates, since September 12, 1983, there is no ICC review available at all. The smaller operator has two options - (1) agree to the terms prescribed by the railroad, or (2) don't ship the coal. The latter option is not viable for the smaller producer with limited operations.

RECOMMENDATIONS:

I. For the reasons outlined above MARC considers legislation necessary to assure that the ICC fulfills the balanced twin goals of the Staggers Act of elimination of unnecessary regulation and the continuance of protection to captive shippers.

Among the critical subjects that must be considered in such legislation are:

- Standards for maximum reasonable rail rates for captive shippers.
- Standards for determination of railroad revenue adequacy
- Standards for determination of railroad market dominance
- Protection against exemption of market dominant traffic from regulation
- Protection against anti-competitive rail actions such as cancellation of through routes, joint rates and reciprocal switching agreements.

THESE ISSUES ARE ADDRESSED IN LEGISLATION, S.1082 AND H.R.2584, INTRODUCED BY SENATOR FORD AND REPRESENTATIVE RAHALL. MARC SUPPORTS THESE PROPOSALS AND URGES THEIR PROMPT CONSIDERATION AND ENACTMENT.

II. RECOGNIZING THAT THIS COMMITTEE DOES NOT HAVE JURISDICTION OVER RAIL ACT CHANGES BUT DOES HAVE JURISDICTION OVER ENERGY POLICY, MARC RECOMMENDS THAT THE COMMITTEE

(1) HOLD SPECIFIC HEARINGS ON THE IMPACT OF RAIL DEREGULATION ON ENERGY POLICY AND PREPARE A REPORT WITH RECOMMENDATIONS FOR THE SENATE;

(2) URGE THE ADMINISTRATION TO FILL THE THREE VACANT SEATS AT THE ICC WITH NOMINEES APPRECIATIVE OF THE INTERRELATIONSHIP BETWEEN TRANSPORTATION POLICY AND ENERGY POLICY; AND

(3) HOLD SEPARATE HEARINGS ON ICC NOMINEES TO REVIEW THEIR QUALIFICATIONS AND VIEWS ON TRANSPORTATION AND ENERGY POLICY.

Senator **WARNER**. Thank you very much. I have no further questions. To allow additional time I will submit questions. I am anxious to move along. However, Mr. Ford?

Senator **FORD**. Just two quick questions—Mr. Moore, is your export to Japan declining?

Mr. **MOORE**. It has declined this year primarily because of the competition I would say from South Africa.

Senator **FORD**. Is it true that we have lost about 50 percent of our coal export to Japan?

Mr. **MOORE**. Yes.

Senator **FORD**. Let me ask you, Mr. Altmeyer—I was sure I was right—you talked about embargos, and we look at the world and I hope somebody will look at "Newsweek" and see how thinly we are spread and how we are located as it relates to our military.

I just asked the distinguished chairman a moment ago—I am not sure I am right on this, but I am close, if somebody wants to correct me, I always look forward to that—but we talk about the Gulf, the Persian Gulf. The Security Council I believe finished their meeting last week with a recommendation that all parties agreed that the war between Iran and Iraq should cease. There is some judgment that Iran will thumb their nose at the agreement and give Iraq then the free hand to go ahead and do whatever they want to do. That means attack the ships coming out of there, damage the pipelines and so forth. That indicates that we are right in trouble again and we will be asked to move in and probably along with France to protect the Straits.

Does this make you nervous as a coal producer seeing we might be right back in the same place we were twice in the seventies and yet we are not prepared for any of that? We may not worry about exports at that time.

Mr. ALTMEYER. Mr. Chairman, I believe approximately 10 million barrels of oil per day move out of the Straits of Hormuz from the oil-producing countries in the gulf region. I believe that approximately 20 percent of the world's consumption of oil on a daily basis comes from the gulf even though the United States has reduced its imports from that region of the world.

The impact on other oil importing countries and the redistribution of the available oil supplies throughout that system would probably cause an immediate increase in the price of world oil.

As you recall, Mr. Chairman, in 1973 with the embargo and in 1977 with the rapid escalation of oil prices the coal industry of the United States was a direct beneficiary because of increased demand for coal.

However, Mr. Chairman, I think in speaking for our members, we would prefer that we have a stable international situation, that our increase in coal exports result in affirmative policies of the American Government to increase utilization of coal so we not be the unintended beneficiary of unfortunate political events in other parts of the world.

Senator FORD. That was well stated. I'm glad I asked that question.

Senator WARNER. Very well stated; it is a long-term contract. It gets us out of the spot market situation. That is the salvation I expect of your industry.

Gentlemen, I think you have fairly, hopefully objectively, framed the indictment, and I will give an opportunity under our system to have the rails reply.

Thank you very much.

Mr. ALTMEYER. Thank you.

Senator WARNER. The rail panel will consist of Arnold B. McKinnon, executive vice president, marketing, Norfolk & Southern, Norfolk, VA; John Hertog, senior vice president, coal and taconite, Burlington Northern Railroad Co., St. Paul; Mr. John W. Snow, senior vice president, corporate affairs, CSX Corp., Richmond, VA; Charles N. Marshall, vice president, marketing, Consolidated Rail Corp. from Philadelphia, PA.

We will lead off with Mr. McKinnon.

STATEMENT OF ARNOLD B. McKINNON, EXECUTIVE VICE PRESIDENT, MARKETING, NORFOLK SOUTHERN CORP., NORFOLK, VA

Mr. MCKINNON. Thank you, Senator Warner, Senator Ford. I am Arnold McKinnon, executive vice president of marketing of Norfolk Southern Corp. Norfolk Southern is a holding company which is a parent of Southern Railway Co., of Norfolk & Western, both of which are substantial haulers of coal in this country.

Senator, I have prepared an extended statement which I would like to submit for the record with your permission, and then make a summary statement of some of the points that are made.

Senator WARNER. We thank you very much, Mr. McKinnon. All witnesses will be given the option of putting their statement in the record and presenting a summary, and I urge that be done.

Thank you.

Mr. McKINNON. We at Norfolk Southern believe that railroads have become more effective competitors both for domestic and export coal transportation as a result of legislative and regulatory developments since the enactment of the Staggers Act.

The most important development in recent times in this area, of course, was the enactment of Staggers in 1980 which relaxed some of the regulatory controls on railroads. That act has become in my judgment an important tool in placing the rail industry on more sound financial basis, but also in permitting the railroads to compete more effectively.

The railroads have taken advantage of the changes brought about by the Staggers Act by actively competing for traffic. I am glad to have the opportunity to talk about what has really been happening in the world rather than some of the what ifs that our other panelists have talked about this morning because I think when you look at what has really happened since the enactment of Staggers, you will see that the railroads have been making a very solid effort to be competitive in the transportation markets. Nowhere has this competitiveness cost more than in our policies and practices concerning the coal traffic.

We have strongly endorsed the Commission's effort to establish a methodology of demand based pricing, pricing that is responsive to the marketplace, and in particular our rates on export coal have in fact increased only modestly since the adoption of Staggers, due in large measure to competition.

We have also endeavored to utilize the Staggers Act contract provisions. In this connection we have been primarily successful in developing service-oriented contracts to improve the movement of coal through our ports to avoid the big queues that we had back in 1981 and early 1982, but in those same contracts we have also had rate stabilization provisions which I think have been quite helpful, in fact, to the coal exporters.

A number of examples will show how the provisions of the Staggers Act, particularly these contract provisions, have been invaluable in responding to competitive pressures and to the needs of our shippers.

First, the successful negotiation of the service-oriented contracts, as I said, was an integral part of our efforts to remedy the huge vessel queues which were outside of our facility at Lambert's Point. The same queues extended on up to Chesapeake Bay. The contracts helped to relieve those queues in 1981, early 1982.

We would not have been able without the contract provisions to make the arrangements for berthing for guaranteed times of loading, unloading which we were able to make, and this saved many thousands and even millions of dollars of demurrage charges to the receivers of the coal.

Second, the contract provisions of the Staggers Act were tremendously helpful in dealing with many section 229 complaints which were filed in 1981 to challenge our coal rates. We are proud of the fact that of the 44 section 229 complaints filed under the Staggers Act against the base level of our domestic rates on coal, 30 have now been settled. Of the remainder, only eight are actively being processed and only a handful of shippers are involved in those cases.

In particular, we were able to resolve one rather notorious rate dispute which involved both West Virginia and Virginia coal mines which operated in competition with Pennsylvania mines not served by Norfolk Southern. By means of an agreement under the Staggers Act contract provisions, which was the agreement reflected in the rail contract, we were able on short notice and in response to market competition to enable one of the companies represented here this morning to reopen the West Virginia mine and to continue the substantial production from Virginia mines to major utilities in the Northeast.

The third beneficial effect that we would point out, when the world demand for U.S. coal slackened recently at the beginning, at about mid-1982, and coal shippers found it difficult if not impossible to perform fully their volume commitments under their contracts with us, volume commitments which would have required them to pay very substantial liquidated damages if they did not meet those commitments, we at Norfolk Southern were able on a case-by-case basis and in recognition of these competitive market conditions, to renegotiate the contracts to relieve the shippers by renegotiating a major part of their contractual obligations and to save them from what could have been financial disaster.

When you talk about rate increases or decreases, this in effect was a decrease in the cost of the shipment of those coal companies with shipments to which they had committed. We recognized that the current export market just didn't justify the volumes that we and they had both anticipated at the time these contracts were made. These renegotiation of contracts to meet shippers' needs were necessary in our view to maintain our position and that of our customers in an increasingly competitive world market.

Fourth, our efforts to promote the sale of U.S. coal abroad are reflected in a recent development, that of our announcing our involvement in a joint venture which will provide, until we have a deeper harbor at Hampton Roads, topping off service for export coal moving out of Hampton Roads.

As I am sure you know, Senator, we have until now been unable to load the supercollier vessels that are becoming very much more predominant in the world market. We are unable to load them to capacity because our harbor is not deep enough to accommodate these huge ships. Our new topping off facilities which we hope to have in operation by the first of the year will vastly improve the efficiency of ocean transport of U.S. coal and will enable a reduction in the delivered price of that coal.

Finally, the flexibility accorded to us by the Staggers Act has assisted us not only in helping to keep the export coal market in Virginia at Lambert's Point, but also in helping to open up competitive coal-loading facilities in Charleston, SC, where we have recently entered into agreement with Mr. Massey, in connection with his facility. He, incidentally, is served by not only us but by our major competitor, so it does have two railroad service facilities at Moorhead City, and Savannah, and also at Mobile, AL.

We have committed as a system to serving all of the export coal facilities that are reached by our line to the extent possible.

The Staggers Act thus was an important step in improving the financial health of the rail industry and in strengthening the competitive position of the Nation's railroads.

Nevertheless, our rate of return remained low and our ability to compete particularly in the export coal market has in the past been impeded in several respects by the continued regulation which did exist under the Staggers Act. These regulatory impediments form the basis for the Interstate Commerce Commission's decision to exempt export coal traffic from further regulation. Norfolk & Western, one of our constituent companies, initiated the export coal exemption proceeding in 1981 because we believed then and we still believe that deregulation of export coal traffic is necessary over the long run to permit us to compete fairly and freely in the highly competitive world market for coal, to assist us in generating sufficient revenues to attract needed capital and to facilitate the negotiation of long-term coal supply contracts.

You mentioned the advantages of those. We certainly very much believe in long-term rail supply contracts which will maintain rate stability and we have told our customers that. Some of them still like to deal in the spot market, but we still stand ready to enter into long-term contracts and think that under deregulation we have a greater ability to do so.

Under the liberal exemption provision in the Interstate Commerce Act, deregulation is called for whenever regulation is not needed to protect shippers from the abuse of market power and is not needed to carry out the national rail transportation policy.

The Commission in granting the export coal exemption in our judgment properly concluded that deregulation of this traffic was consistent with these standards. There is widespread agreement with the comments made earlier today that the world market for coal is pervasive today and sets a limit on the net delivered price of U.S. coal sold abroad. The foreign buyers can look to a variety of supply nations, no one of which, including the United States, is preeminent because price is a primary determinant of market share. This is even more true I think in the area of steam coal than in met coal, but it is true in both areas. Any increase in the delivered price of U.S. coal will cause purchasers to look to other nations such as South Africa, Poland, and Australia to meet their demand.

Incidentally, I might comment at that point there has been a good bit of emphasis on the very sharp reduction between 1982 and 1983 in the export coal movement from this country. I think it is fair to state for the record that for all of us to recognize that 1982, particularly the period from mid-1982 to mid-1983, was in modern times the highest demand period for our domestic coal of any period say in modern times, and in large measure—and this also affects the statistics about market share between us and some of the other coal countries, Poland and Australia, for example—in large measure Poland was out of the coal market because of their own domestic difficulties and Australia was out of the coal market because of labor difficulties.

Clearly when those matters were resolved, Poland has come back into the market at prices that I think all of us recognize are simply ones to generate foreign exchange, but when they are back in the market, their share is going to go up and our market share is going to go down, and world competition will be increased, but we do agree that this competition exists.

We also think it acts as a significant restraint on pricing action on all participants in the chain of production, including the coal mine operators and the railroads.

In addition to this worldwide competition, a number of factors here in the United States ensure that in a deregulated environment railroads will not and cannot abuse market power. The shippers have argued that the railroads will appropriate themselves all of the profits from the export coal trade by imposing unreasonably high rail rates.

The Commission heard this argument, considered it fully, and soundly rejected it. The Commission finding, I think the record is set, fully supports that shippers of coal enjoy substantial power in their dealings with the railroads. For example, the Commission explained that the coal shippers are dominated by large companies which ship coal from a variety of mines served by different railroads.

The record in the exemption proceeding and our internal records show that in 1981, 4 companies were among the top 10 shippers on each of the Norfolk & Western, Chesapeake & Ohio, the Baltimore & Ohio Railroads, while 3 others, that is talking now about 7 out of the top 10, were among the top 10 shippers on 2 of these railroads. These companies also frequently act as brokers or transshippers for smaller mines by collectivizing small shipments to fill larger orders. Since these transshippers can fill their orders for mines served by different railroads, they can respond to unreasonable pricing action on the part of one railroad by threatening to shift production to mines served by another railroad.

This ability to shift production gives coal shippers substantial bargaining leverage and acts as a genuine deterrent to an attempted monopoly pricing by railroads.

Also in some of the statements this morning it has been suggested that these coal companies were not perhaps of a size to exercise any market power over the railroads. I think it is worth noting that they are largely on their own, and Mr. Massey's company, for example, its major shareholdings are held by Consolidation Coal, which is controlled by Conneco, which in turn is controlled by Dupont. Island Creek Coal Co. is controlled by Occidental Petroleum. They are in the big leagues. We are playing with the big boys when we are negotiating with them, and we recognize that. We know we are not in a position to shove them around.

Shippers also enjoy alternatives to rail transportation such as barge and truck movements. It has been suggested here today that the barge movements were not meaningful. Certainly in our area we find that a very large portion of coal moves on the rivers to Senator Ford's areas, for example, through the river system; in New Orleans to other ports to domestic power companies. That coal is often not moved from origin to the rivers by rail but by truck. We find it real competition.

I also have found cases in the last few months where we have coal moving from Tennessee and Kentucky into North Carolina by truck at rates that are so low that we cannot compete. We would be below our basic out-of-pocket costs to handle this coal. Part of it is the nature of the competitive market that is out there today, but that is competition in the real world.

Shippers may also choose to sell in regulated domestic coal markets if rail rates on export coal become unreasonably high. All of us recognize that today those markets are depressed and we would all like to see them come back to a stronger position.

These factors combined with ever-increasing product competition and geographic competition mean the railroads cannot extract all of the available profits from the export of coal trade. Again, I said I would like to comment on what has really happened in the world or rates rather than what might happen, what could happen if the railroads took an unrealistic position about rail rates.

The recent history of rail rates on export coal reflects competition of the world market and the relatively equal bargaining power of railroads and shippers. The most significant fact is that export coal rates have not increased dramatically. Indeed prior to 1981 not a single complaint was filed with the Commission challenging our rates on export coal. In 1981, complaints were largely motivated by the hunting season created by section 229 of the Staggers Act.

However, the Staggers Act provisions were actually beneficial in permitting us to resolve disputes with various shippers which joined in section 229 complaints attacking our export coal rates. With the help of the flexibile provisions of the Staggers Act we have been able to reach favorable settlements with many of the shippers. Among the important shippers that have withdrawn from export coal complaint cases are Island Creek Coal Sales Co., Consolidation Coal Co., Bullitt, which is an affiliate of Eastern Associated Coal Corp., Massey Coal Corp., Virginia Iron Ore & Coke Co., John K. Irish & Co., and others.

We are satisfied that the flexibility that we have had under Staggers enabled us to work out the agreements which did result in many of these withdrawals.

During the past several years we have taken only modest increases on our rates for export coal and voluntarily declined a number of scheduled increases authorized by law.

Over a longer term, it is easy to show that the railroads have not extracted the bulk of the profits from the export coal trade. Between 1960 and 1979, average rail rates on export coal increased 294 percent while coal prices during the same period were rising 811 percent. If shippers were as powerless in their dealings with the railroads as they say they are, it would have been the railroads, not the shippers, that captured these profits in the 1970's.

In 1983 we have not taken any of the cost-recovery increases which we would have been permitted to take under the Staggers Act. In fact, today probably well over 50 percent, probably closer to 80 percent of our export coal through Hampton Roads moves under contracts which not only permit cost-recovery increases but mandate cost-recovery decreases when as in April the cost-recovery index goes down. We have, of course, pursuant to the provisions of contracts, granted the cost-recovery decreases and in fact we have, despite the contracts, not taken the cost-recovery increases under either of the contracts on our carrier coal agreements.

We think this is a recognition of the conditions in the marketplace and it is in fact, since this is related to cost, it is a real reduction in rates for the coal exporters and for the foreign shippers.

At that point I would mention one other thing, and it has been mentioned a good bit here today. This is the NERA study and the fact that it suggests what would happen if coal rates were raised 15 percent a year.

First, I think everyone recognizes that this study was by a profit-making research organization which was engaged as a witness for the opponents to the coal exemption.

Second, the record contains equally I think persuasive evidence that this was not what would happen, but beyond that, the 15 percent a year increases talk about what might happen if the railroads decided they wanted to commit economic suicide. Obviously, Senator, we don't want to put the American coal exporters out of business. We would be putting ourselves out of business if we did so, and I think that the Commission recognized this in their decision.

Just to follow that point a little further, it is a little bit like Henny Penny saying the sky is falling and saying since we could increase the rate 15 percent a year, we would. In fact, since the adoption of Staggers and under the provisions which were established to help the railroads reach revenue adequacy which the Congress recognized we had not reached, we would have been eligible in addition to cost recovery increases, to put in a 6 percent a year revenue need increase. In fact, in the total time that would be to date 18 percent if we could have increased the rate.

To date, there has been only one 3-percent revenue need increase, and in fact that would not apply to the export coal. What I am saying is that if you look not at the rhetoric, not at what might be but at what has happened in the real world since the passage of Staggers, there has been a recognition of economic reality.

[The prepared statement of Mr. McKinnon follows:]

STATEMENT OF ARNOLD B. MCKINNON

Executive Vice President -- Marketing
Norfolk Southern Corporation

Subcommittee on Energy and Mineral Resources
of the
Committee on Energy and Natural Resources

United States Senate

November 15, 1983

Mr. Chairman and members of the Subcommittee. I appreciate this opportunity to testify with respect to the United States coal transportation system and, more specifically, the role of the nation's railroads in making that system one of the best in the world. We at Norfolk Southern believe that the railroads have become more effective competitors both for domestic and export coal transportation as a result of legislative and regulatory developments occurring during the last three years. I would therefore like to focus my remarks on those developments, with particular reference to the recent decision by the Interstate Commerce Commission (the "Commission") to exempt from further regulation the transportation of export coal by rail carriers.

United States export coal policy, at least insofar as it relates to the rail industry, must be analyzed against the backdrop of the Staggers Rail Act of 1980. That statute, which relaxed some of the regulatory controls on railroad operations, was prompted by Congress's findings that the rate of return earned by railroads was too low to attract needed capital and that federal regulation was a primary cause of this financial shortfall. Congress concluded that the best means of restoring the financial health of the rail industry in the face of growing competitive pressures was to reduce existing regulation and to permit, so far as possible, competition and the demand for service to establish reasonable rail rates.

The railroads have taken advantage of the changes wrought by the Staggers Act by actively competing for traffic. Nowhere is this competitive posture more evident than in our policies and practices concerning coal traffic. We have strongly endorsed the Commission's efforts to establish a methodology of demand-based ratemaking. We have also held the line as best we can on our coal rates. In particular, our rates on export coal have risen only modestly, as the strong competition we face from foreign coal suppliers, other rail carriers and other transportation modes has forced us to keep our rates at competitive levels. Moreover, we have endeavored as best we can in the post-Staggers Act period to negotiate long-term coal contracts, which offer numerous advantages in the form of more efficient structuring of operations and more accurate projection of future revenues and planning of investments.

Taken together, the provisions of the Staggers Act, especially its contract provisions, have assisted the railroads immeasurably in responding flexibly to many types of shipper problems and to certain market conditions affecting our service. As a result of these changes in the law, the large majority of our coal exports moving by rail now is transported pursuant to contracts. For reasons I discuss below, however, most of these contracts are service-oriented.

Several examples will show how the Staggers Act has helped us in meeting shipper needs. First, the successful negotiation of service-oriented contracts was absolutely critical to the response of the Norfolk and Western Railway Company (NW) (now a subsidiary of Norfolk Southern Corporation) to the huge vessel queues outside our Lamberts Point export coal pier facility in 1981 and early 1982. By means of these contracts NW and its shippers were able to improve the efficiency of our coal loading operations, and thereby increase overall tonnage of coal exported.

Second, the contract provisions of the Staggers Act have proven enormously helpful in dealing with the troubling questions raised by the numerous Section 229 complaints filed in 1981 to challenge our domestic and export coal rates. Through the vehicle of settlement agreements reflected in rail contracts, we have been able to respond satisfactorily to many of the concerns articulated in these complaints, including problems regarding service. We are proud to report that of the 44 Section 229 complaints filed against our domestic rates on coal, 30 have now been settled. Only eight of the remaining cases are actively being litigated. The Staggers Act provisions have also been beneficial in resolving disputes with various shippers which joined in the Section 229 complaint attacking our export coal rates. With the help of the flexible provisions of the Staggers Act we have been able to reach settlements with many of the complaining shippers. Among the important shippers that have withdrawn from the export coal complaint case are Island Creek Coal Sales Company, Consolidation Coal Company, Castner, Curran & Bullitt, Inc. (an affiliate of Eastern Associated Coal Corporation), Massey Coal Export Corporation, Virginia Iron, Coal & Coke Company, John K. Irish & Company, Inc., and others.

I would like to focus more closely on one case in which the contract provisions facilitated settlement of a rate dispute. One of the Section 229 complaints involved our coal rates from a West Virginia mine operated by a major producer to destinations in New England. The dispute was acrimonious and resulted in a brief shutdown of the mine. NW was able, however, to sit down with the complainant and on relatively short notice negotiate a contract that reopened the mine. Our ability to resolve this difficult situation to the satisfaction of the shipper and the Governor of West Virginia was attributable in large measure to the existence of the contract provisions of the Staggers Act.

The flexibility accorded to the railroads by the Staggers Act is also exemplified by several other developments. When the world demand for U.S. coal slackened recently and coal shippers found it difficult if not impossible to perform fully their contracts with us, we at Norfolk Southern were able, on a case by case basis, to renegotiate the contracts to relieve some of our shippers of a part of their contractual obligations. It has been our belief that these renegotiations were necessary to meet the demands of competition in the world coal market. In addition, NW has been able to work with its shippers (and with its merger partner, the Southern Railway) to open up new port facilities and to increase and diversify coal loading facilities on the east coast. An example of this diversification is the arrangement we made with A.T. Massey Coal Company for the movement of coal to its facility at Charleston, South Carolina. Another example is the facility at

Morehead City, North Carolina, which was made possible by a favorable rail contract with us. These beneficial developments can be credited as by-products of the Staggers Act and the regulatory flexibility it fostered.

The Staggers Rail Act was an important and successful step toward the improvement of the financial health of the rail industry and the strengthening of the competitive position of the nation's railroads. Nevertheless, our rates of return remain low, and our ability to compete, particularly in the world market for coal, has been impeded in several important respects by continued regulation. It was these regulatory impediments and rigidities that formed the basis for the Commission's decision to exempt export coal traffic from continued regulation -- a decision that is fully consistent with and, indeed, builds upon, the course charted by the Staggers Act.

As you know, NW initiated the export coal exemption proceeding in March of 1981 by filing a petition with the Commission pursuant to its statutory authority to grant exemptions from regulation. 49 U.S.C. § 10505. We believed then, and still believe, that deregulation of export coal traffic is necessary to permit us to compete fairly and freely in the highly competitive world market for coal, to assist us in generating sufficient revenues to attract needed capital, and to facilitate the negotiation of long-term coal supply contracts. The Commission, after hearing expert evidence concerning the competition in the world market and the substantial bargaining power that U.S. coal shippers enjoy in their dealings with the railroads, agreed with us and granted the exemption. The Commission found on the basis of this evidence that continued regulation of export coal is not necessary to protect coal shippers from the abuse of market power and is not needed to carry out the national rail transportation policy. The Commission's decision was immediately challenged by two shipper groups and the case is now pending before the United States Court of Appeals here in Washington, D.C. The shippers filed their briefs in the case in late September of this year and the Commission filed its brief on November 3, 1983. The Commission's decision has been endorsed by the United States Department of Justice, which joined the Commission's brief in the Court of Appeals.

Today, I would like to review briefly some of the evidence that led the Commission to conclude that continued regulation of export coal traffic is not necessary to protect shippers or to assure reasonable rail rates.

The Commission's decision to exempt export coal was based in substantial part on evidence showing that the world market for coal is pervasively competitive. Foreign purchasers of coal may look to a variety of supplying nations, each of which has coal reserves in adequate supply and quality to meet existing and projected demand. No one supplier is preeminent. For example, as of 1980, the United States accounted for just over 20 percent of world steam coal exports, less than the shares of South Africa (32 percent) and Poland (30 percent) and only slightly above the combined share of Canada and Australia. Even when metallurgical coal is included, the competition facing the United States is evident: the share of the United States (35 percent) is almost equalled by the combined shares of Canada and Australia (33 percent) and of Poland and South Africa (32 percent). These competing suppliers of coal in the world market have pursued aggressive marketing practices (often government-sponsored) to promote their coal exports. These efforts have been facilitated by the advantages these suppliers enjoy in terms of proximity to the purchasing nations and of lower costs of production. As the Commission observed, the delivered price for steam coal from Appalachian origins to Europe in 1980 was some 21 percent higher than the price of South African coal. Foreign buyers are willing to pay a premium for American coal because of its high quality and reliability of supply, but that premium is already reflected in the price of our coal.

The result of this strong worldwide competition is that export coal tends to move on a net delivered price basis. This was confirmed recently by a GAO Report on U.S. steam coal.* The report concluded that the delivered price of U.S. steam coal will continue to be "the major determinant" of U.S. market share. Any increase in the net delivered price of U.S. coal will result in a loss of market share as buyers look to alternative suppliers to fill their orders. The forces of world competition, then, establish a ceiling on the delivered price of U.S. coal. Any attempt to charge monopoly prices at any point in the chain of production -- be it the coal mine operators, the transshippers, the railroads or other inland transporters, or the ocean carriers -- would have ruinous consequences in the form of lost coal exports and diminished profits for all. The mere prospect of such losses acts as a significant restraint on the pricing actions of the railroads, as well as the other links in the chain of production.

Recent events highlight this competition in the world market. The period from 1979 until mid-1982 represented a boom period for U.S. coal exports, due largely to supply disruptions in the other coal producing nations and to the sharp increase in oil prices in 1979. By 1982, however, a number of factors combined to erode the demand for U.S. coal. Poland, whose coal production had suffered dramatically during that country's labor strife and political turmoil in 1980 and 1981, has sharply increased its production. Poland's resumption of production has been aided by large price cuts motivated by a desperate need for foreign exchange. Australia has also resolved its labor problems and now stands as a more formidable competitor in the world market. These developments, coupled with the stockpiling of coal in Europe and the world recession, as well as aggressive marketing by South Africa, have tightened the competitive pressures on U.S. coal. These events serve as vivid evidence of the vigorous competition characterizing the world market for coal.

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* "Prospects for Long-Term U.S. Steam Coal Exports To European and Pacific Rim Markets," GAO/NSIAD-83-08 (August 4, 1983), at 16.

Beneath the price ceiling set by the forces of worldwide competition for coal, the delivered price of U.S. coal must still be shared among the various participants in the chain of production, *i.e.*, the coal mine operators and transshippers, the railroads and other inland carriers, the dock operators, and the ocean vessel owners. It is worth noting that prior to the Commission's decision to exempt export coal, the railroads were the *only* participants in this chain whose pricing decisions were hampered by regulation. How the profits from the export coal trade will be shared among these participants is frequently discussed in terms of the division of economic rents -- that is, the difference between the total costs of production and transportation, and the delivered world market price. To illustrate with a rather simplified example, if the net delivered price of U.S. coal at the port is $50 per ton, and if the coal producer can supply a ton of coal for $20 while a railroad can transport it at a cost of $20, the available profit or rent to be divided between them is $10. The division of that economic rent will be made through negotiation and will depend on the relative bargaining strength of the parties.

The opponents of exemption have argued that the railroads in an exempt environment will appropriate all available economic rents to themselves or, even worse, will force the coal shippers to pay such exorbitantly high rail rates that they will be unable to earn an adequate return. This contention was soundly rejected by the Commission on the basis of evidence submitted by distinguished economists. They explained that no party to the negotiations can be compelled to accept a share of rent below its variable costs of service, including an adequate return on investment.

Otherwise, that party will cease production or service and all participants will lose the benefits of the sale of coal. Within the limitations imposed by each party's variable costs of service, the parties' relative bargaining leverage dictates how the rents will be shared.

Each link in the chain of production has powerful incentives to reach agreement on the division of economic rents, for the consequences of a failure to agree are harsh -- and this is especially true for the railroads. A railroad that is unable to agree with a shipper on acceptable rates loses the movement and can never be certain that the traffic loss will be made up from another shipper located on its own rail lines. Rather, it is just as likely that the loss of a particular movement will be made up, if at all, by mines served by a competing rail carrier, or will simply be lost to foreign suppliers. The railroad in this situation thus has no means of avoiding or even mitigating the losses imposed by the failure to agree on a division of rents. This fact, viewed in the context of the enormous capital investments the railroads have made in facilities serving only export coal traffic, demonstrates that railroads are dependent on the mines they serve and have every incentive to maintain traffic volumes even if this means that they cannot appropriate all or even a substantial share of the economic rents from export coal.

The coal shippers also have incentives to reach agreement with the railroads on the division of economic rents. But coal shippers often enjoy alternatives that avoid, or at least mitigate, the consequences of nonagreement. These alternatives give the shippers substantial bargaining leverage in their dealings with the railroads.

Although the coal shippers are fond of saying that export coal is captive to individual railroads, the truth is that coal producers and shippers enjoy significant bargaining power vis-a-vis the railroads. As the virtually uncontested evidence in the exemption case shows, the coal exporters are, by and large, dominated by huge mining companies, which are in many cases themselves owned by larger integrated and multinational interests. These large companies dominate shipping on NW and the other eastern coal-hauling roads. In 1981, for example, a mere six shippers accounted for 69.5 percent of all shipments through our Lamberts Point export facility, and eight accounted for over 82 percent of such shipments. The concentration on our competitor, the Chessie System, was also great: six shippers there represented 57 percent of all shipments.

Many of these large coal companies also act as transshippers or brokers for smaller producers by collectivizing coal from various small mines to fill large orders. Indeed, some transshippers move coal exclusively from the mines of others. The important fact, however, is that these large transshippers have access to more than one railroad. As a result, the record in the exemption case showed that in 1981 four companies were among the top ten shippers on each of NW, the Chesapeake and Ohio Railway (C&O), and the Baltimore and Ohio Railroad (B&O), while three others were among the top ten shippers on two of these railroads. Moreover, by focusing just on large mines (250,000 tons or more), it can easily be seen that these large transshippers have effective rail alternatives. For example, Pittston in 1980 owned 11 large mines in West Virginia. Of these 11 mines, two were served by NW, five by B&O, and four by C&O. Of Consol's 23 large mines in West Virginia, nine were served by NW, one by B&O, four by C&O, seven by other railroads, and three relied on river transport. Significantly, every one of the six largest shippers on NW had mines served by competing carriers.

The significance of this concentration is that the large transshippers can fill their orders from a variety of mines located on different railroads. If one railroad attempted to demand unreasonably high rail rates, these large transshippers could respond with a credible threat to shift their production to mines served by other rail carriers or by other modes. The mere possibility of such a diversion of traffic, and the devastating revenue losses that would be associated with it, are enough to confer on shippers substantial bargaining power in their dealings with the railroads. Thus, the coal shippers are not generally captive to individual railroads even if we accept the proposition, frequently cited by the shippers, that a large proportion of individual coal mines are served by only one railroad. A substantial majority of coal exports is controlled by large and powerful companies which are in a position to exact significant bargaining concessions from the railroads.

The restraining influence of these and other factors on the pricing actions of the railroads is by no means based on mere theory or speculation. These competitive influences are also evidenced in the pricing policies of NW and the other coal-hauling railroads both today and in the past.

We at Norfolk Southern are acutely aware of the forces of world competition for coal and of the prospect that any attempt by us to extract a substantial portion of the economic rents from export coal traffic will force our foreign customers to turn to coal sources served by other rail carriers or other transportation modes or to coal produced by other exporting nations. We have made serious and ongoing efforts to maintain our rates at levels that maximize traffic volumes and keep as many mine operators as possible in the market. This strategy is not philanthropic -- in view of the substantial investment we have made in the export coal industry and our dependence on export coal for a substantial portion of our revenues, this strategy of maximizing traffic volumes makes good business sense.

Recent history also fully supports our view that the railroads have not exploited and, indeed, cannot exploit market power to the detriment of coal shippers. It is significant that prior to 1981 not a single maximum rate complaint concerning export coal was filed with the Commission, in striking contrast to the large number of complaints attacking increases on domestic movements of coal. (Moreover the 1981 complaints were largely motivated by Section 229(b) of the Staggers Rail Act, which established a "hunting season" on rail rates.) The railroads during this period were instead voluntarily declining to increase their rates on export coal. We were content to rely on general rate increases and NW declined even some of those opportunities. More recent statistics confirm this pattern. Since January of 1982, NW has taken no increase in its tariff rates on export coal to Lamberts Point even though quarterly increases were authorized by law. Similarly, on our export coal contracts, we have not taken all of the quarterly increases to which we were entitled. Other carriers have responded similarly to market conditions. Recently, Conrail announced a reduction in export coal rates to its newly upgraded facility in Philadelphia. There is little doubt that competitive pressures in the world coal market, as well as competition from NW and other railroads, prompted Conrail's rate reduction.

Other statistics confirm that NW in particular has acted reasonably and responsibly in the face of a depressed world market for U.S. coal. This is reflected in our revenue levels and tonnage shares on export coal traffic. Since the first quarter of 1981, for example, the increase of the average revenue per ton for NW-origin coal moving for export has been held down below the increase for all NW-origin coal. In the second quarter of 1983, average revenue per ton for NW-origin coal for export reflected only a 9 percent increase over the average revenue for the first quarter of 1981. In the same period, the average revenue per ton of all NW-origin coal increased 15 percent and the Consumer Price Index for urban consumers rose 12.8 percent. In fact, export coal origin average revenues have remained basically constant since the first quarter of 1982.

Comparison of NW Average Coal Revenue per Ton and
Consumer Price Index
(First Quarter 1981: Index 100)

	NW Origin Export	NW Total Origin	CPI Urban Consumers
1981 - First Quarter	100	100	100.0
Second Quarter	102	104	102.3
Third Quarter	103	108	105.3
Fourth Quarter	106	112	106.7
1982 - First Quarter	109	119	107.6
Second Quarter	110	120	109.2
Third Quarter	110	118	111.2
Fourth Quarter	110	116	111.5
1983 - First Quarter	110	114	111.4
Second Quarter	109	115	112.8

The recent reduction in U.S. export coal tonnage reflects market conditions and not unrestrained rate action. This can easily be demonstrated by comparing export coal through Norfolk with total origin coal for the three principal states of NW-origin coal during the period beginning in 1980 and through the first six months of 1983. In 1980, export coal through Norfolk represented 41.2 percent of NW-originated coal in the states of Kentucky, Virginia and West Virginia. In 1981 and 1982, the export tonnage percentages were 41.8 percent and 47.7 percent, respectively. In 1983, the export tonnage at Norfolk was 41.4 percent, comparable to the relationships in 1980 and 1981 and slightly below the 1982 level. If the decline in U.S. export coal tonnage were attributable to rail rate increases, one would not have expected that the share of NW-originated export coal would have remained practically constant over this period.

Comparison of NW Origin Coal for States of
Virginia, Kentucky and West Virginia
With Export Coal Through Norfolk
(Millions of Tons)

	Origin Coal VA. KY. W.VA.	Export Norfolk	Percent Export of Origin
1980	74.0	30.5	41.2
1981	76.2	31.9	41.8
1982	72.5	34.6	47.7
1983 (6 months)	29.2	12.1	41.4

I believe we have done a good job of selling our services via our Lamberts Point facilities at Norfolk. In 1981, Lamberts Point's share of coal exports through east and Gulf Coast ports was 38.9 percent. In 1982, while tonnage was down, our share increased to 44.5 percent, and for the first seven months of 1983, our share was 49.3 percent. These comparisons of rate levels and tonnage shares are of little solace to the producer faced with reduced production. However, I believe they do reflect the fact that we are trying to maintain the interest of our coal producers in the world coal market.

Even over a longer term, the facts show that the railroads have not captured all of the economic rents from export coal. This is reflected in data submitted in the exemption case and relied on by the Commission. Between 1960 and 1979, average rail rates on export coal increased 294 percent, from $4.08 to $11.98 per ton. During the same period, export coal prices (F.O.B. mine) increased 811 percent, from $5.12 to $41.51 per ton, with the greatest increase occurring during the Arab oil embargo. If the railroads had the market power attributed to them by the coal shippers, then it would have been the railroads and not the producers that would have captured these profits in the 1970's. But in fact, railroad rates (per ton) as a percentage of coal prices (per ton) dropped from 80 percent in 1960 to only 29 percent in 1979. These figures are plainly at odds with the coal shippers' portrayal of the railroads as avaricious monopolists.

This extended analysis of the world market for coal and the position of the U.S. participants in that market has demonstrated that the Commission's decision was fully warranted. Continued regulation of export coal is not necessary to protect shippers from the abuse of market power by rail carriers and is not needed to carry out the national rail transportation policy, including the policy of maintaining reasonable rail rates. These findings were clearly sufficient to justify the Commission's action, for the exemption provision in the Interstate Commerce Act commands that exemptions be granted whenever continued regulation is unnecessary. However, the export coal exemption is also sound for several affirmative reasons as well.

First, the exemption of export coal will free the railroads to participate as equals in the chain of production that constitutes the U.S. export coal industry. Exemption will permit the railroads to negotiate for a fair share of the economic rents from this traffic, free from the regulatory impediments which until now have been imposed only on the railroads. This freedom, as the Commission found, will help contribute to the improvement of the railroads' revenue adequacy. As you know, the unmet revenue needs of the railroads were the principal motivating force behind recent legislative enactments affecting the railroad industry. Only recently, the Commission released its 1982 revenue adequacy determinations, in which it found that the railroads' return on investment should be at least 17.7 percent in order to attract capital. All of the eastern railroads, however, had rates of return significantly below this target level. For example, in 1982 NW had a rate of return of only 8.03 percent while Norfolk Southern's overall rate of return was a mere 6.8 percent. If we look instead at more recent data, the shortfall is even greater: during the split-year period consisting of the last quarter of 1982 and the first three quarters of 1983, the rates of return for both NW and Norfolk Southern slipped below a meager 5 percent. These low rates of return are fundamentally inconsistent with the claim that NW and the other major coal-hauling railroads are monopolies with respect to coal traffic, and provide an affirmative reason for granting the exemption.

Another important reason for granting the export coal exemption is that it will facilitate the negotiation of long-term coal contracts. The evidence presented to the Commission showed that, although recent amendments to the Interstate Commerce Act have given the railroads a measure of freedom to contract, regulation has inhibited free contracting between railroads and shippers of export coal. As noted, most of the contracts that were entered into by NW were service-oriented and while they guaranteed the shipper rate stability during the term of the Contract did not reflect rates varying significantly differently from the tariffs. Some transshippers have insisted that long-term contracts contain a "most favored nations" clause, which gives them the benefit of any Commission-mandated reduction in rates obtained by complaint of other shippers. This insistence by shippers is only natural, for it protects them from the competitive disadvantage that would result if they were locked into a specified contract rate while other shippers secured lower rates by Commission order. However, such clauses would deprive the railroads of an assured price for their transportation service and thereby remove the certainty that railroads (like any party) seek in entering into such long-term contracts. Exemption from regulation would remove these inhibitions on contracting and permit railroads to project more accurately their expected revenues and plan long-term investment. The Commission found -- properly, we believe -- that fostering the use of long-term contracts would serve the interests of all affected parties and the public generally.

Finally, the exemption of export coal is absolutely critical for the railroads to have the necessary flexibility to respond promptly and appropriately to changes in the world market for coal. All participants in the chain of production are harmed if any one of them is unable to respond quickly to fluctuations in the supply of or demand for U.S. coal. Until recently, the railroads were prevented by regulation from acting flexibly in response to market forces. If alterations in the world coal situation called for a reduction in our rates to meet competition or slackening demand, we were reluctant to do so for fear that any subsequent efforts to return our rates to a higher level would be met with vigorous and costly regulatory challenges by coal shippers. Although the Staggers Act conferred substantial freedom to increase rail rates on traffic that is not market dominant, the mere filing of a rate complaint (however frivolous) and the possibility of a suspension of our rate increase could impose on us significant losses. Rather than risk having such challenges keep our rates artificially low, we and other railroads were understandably reluctant to reduce our export coal rates even when market conditions called for such action. With the exemption of export coal, however, we are free to adjust our rates in conformity with the dynamic conditions existing in today's market for coal.

Before concluding my prepared statement I would like to address one other issue that has been raised with respect to the Commission's exemption decision and about which there has been a considerable amount of controversy and confusion.

It has been suggested that the exemption of export coal will result in a substantial reduction in coal production in several regions of the country, most notably, Virginia. This contention rests entirely on a misunderstanding of the extensive Environmental Assessment prepared by the Commission in connection with its decision. A fuller understanding of the Environmental Assessment will show that there is a simply no basis whatever for the assertion that the exemption decision will cause coal production in areas such as Virginia to decline.

The Environmental Assessment found that the only perceptible environmental impacts attributable to the exemption would be those impacts resulting from fluctuations in coal production and transportation in response to changes in rail rates. To measure this impact, the Environmental Assessment examined and compared two possible scenarios. The first scenario, called the "base case," assumed that there would be no change in rail rates for coal. Based on this assumption the Environmental Assessment projected U.S. coal production for the years 1985, 1990 and 1995. The second scenario, called the "composite scenario," assumed that export coal rates would increase (on average) at a rate of 10 percent each year, while domestic rates increase as allowed by the Commission's recent decision in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines -- Nationwide (decided February 8, 1983). The Environmental Assessment then projected the effects such hypothetical rate increases would have on coal production. Not surprisingly, the Environmental Assessment found that the higher rates assumed in the composite scenario would yield lower volumes of coal production and export than were projected under the base case assumptions. The Environmental Assessment also found that several geographic regions (including Virginia) would be particularly hard hit by the production losses resulting from the assumed increases in rail rates.

It must be stressed, however, that this projection of diminished coal production was based on a mere assumption of a huge and unprecedented rate increase of 10 percent each year over an extended period of time. The Environmental Assessment did not purport to find that rail rate increases of this magnitude would ever occur. It simply made this "worst case" rate assumption in order to measure the maximum potential impact of the exemption on coal production and on the physical environment. Indeed, the Commission itself found, on the basis of other expert evidence, that the assumption of a 10 percent annual increase in rail rates was much too high, and that the more likely prospect is that rail rates will increase very little on average (a finding amply supported by the record of conservative export coal rate increases which I discussed earlier). Thus, the Environmental Assessment never found that rail rates on export coal would increase following exemption, and the Commission explicitly found that the exemption would have little or no effect on rail rates generally or on the volume of export coal movements. There is accordingly no basis at all to fears that the exemption will lead to a reduction in the level of future coal production in areas such as Virginia.

Senator WARNER. On that point, Mr. Rogers in his testimony, page 6, and I quote:

> In 1981 our utilities paid $5 billion to move their coal on the railroads. As a result of the ICC actions, they expect these costs to double in 5 years, triple in 8 years, and to quadruple within 10 years.

Is that fair?

Mr. MCKINNON. I think, Senator, that is if we were to get our revenues to the point where the economists say they should be if we are going to recover the cost, the current cost of capital. If we would get them to that point, you might have such a doubling, but we recognize that we are not able to impose such increases.

The Staggers was not a guarantee of those increases. It was just giving you more freedom to reach that revenue adequacy than you had in the past, but we are talking about domestic utilities. We are faced today with suggestions and in negotiating sessions with our major utilities that they do have access to water movements. On our line certainly they have access in most cases to alternative rail movements, and with those situations, while we would be delighted if we could become revenue adequate in the sense that we are talking about here, the marketplace will not let us.

I think again this is what could happen if the maximum possible increases were imposed, but as I say, that has not been the case since the adoption of Staggers. We conclude there is simply no basis to the suggestion that the railroads will, in the exempt environment, appropriate all or even a substantial share of the profits to be earned for coal export. Rather present forces of competition both in the world market and here at home are more than adequate to ensure reasonable rail rates.

The Commission's exemption decision was, therefore, fully warranted by the evidence. The exemption of export coal will free the railroads to compete more effectively to assist us in earning sufficient revenues and will foster the negotiation of genuine rate contracts.

By helping us to be more responsive to our customers' needs and to demands of a dynamic market, the export coal exemption will benefit not only the railroads but the coal shippers and the public generally.

I appreciate the opportunity to testify, Senator.

Senator WARNER. Thank you very much. We have to step up our pace here a little bit. That was a very thorough review and I hope the other witnesses, feeling that they might have comparable points, would defer to your colleague as having made forcefully those points.

Mr. Snow.

STATEMENT OF JOHN W. SNOW, SENIOR VICE PRESIDENT, CORPORATE AFFAIRS, CSX CORP., RICHMOND, VA

Mr. SNOW. Thank you very much, Senator. My formal testimony can be submitted for the record and I will briefly summarize it.

I can adopt virtually everything that Mr. McKinnon said. His experience under Staggers parallels our own. Sometimes a page of history is worth a volume of logic, and I think that is the case here.

If we go back 3 years and look at the conditions of the railroad industry in the 1970's, that led up to the Staggers Act, it was clear that Congress was addressing a pressing and serious problem. It was addressing the problem of an industry in a deeply troubled state and answers had to be forthcoming. Several railroads were in bankruptcy. Earnings were chronically depressed. Market shares had been falling for years. We were living in the aftermath of the Penn Central collapse and the whole collapse of the Northeast rail system. Conrail was struggling to become a viable rail system, and so on. You know that history as well as I.

The Staggers Act was designed to deal with that problem, and the underlying purpose of the Staggers Act was to deal with what Congress identified as a clear problem, the problem of an antiquated regulatory system that had its origins prior to the turn of the century in the horse and buggy age of transportation.

Today 3 years later the rail industry is more competitive. It is more innovative. It is more market responsive. It has weathered the most serious recession in 40 years, a recession which in other times would have seen further collapse of the rail system and many bankruptcies.

While we are on the right road and progress is being made, still we are far from realizing the underlying objective of revenue adequacy. The Staggers Act was designed really to limit regulation to those areas where it was needed to protect captive shippers, in other areas to let railroads price and compete in the market system. It created pricing flexibility in the 4- and 6-percent zones. It gave us the right to engage in contracts, gave the ICC broad authority under certain conditions to provide for exemptions from regulation, and importantly and often forgotten, it eliminated the rate bureaus as we have known them throughout railroad history. It eliminated the ability to engage in collusive or collective ratemaking.

Now some of the ICC decisions have raised criticism from some quarters, particularly the coal industry, and particularly I have reference to the coal export decision, the exemption decision and the 347, the guidelines decision.

We embrace both of those decisions and think they are consistent with and fulfill the purpose of the act, and against the rhetoric that suggests that railroads with the freedoms given by Staggers and by the ICC under those decisions will gouge the public in some unconscienable way, I simply lay before you because I do in my testimony the road of our experience since Staggers, and in that period, in sum, our coal export rates are lower today on a constant dollar basis than they were in 1980.

Our domestic coal rates are lower today in real terms than they were in 1980. We have put into effect a number of contracts. We have used the contract provisions of the act to give the shippers lower rates and to create for ourselves some stability in our future traffic. They have benefited and we have benefited.

A prime example is the Vepco contract which is saving Vepco $7 million a year annually. So against the charges of abuse of pricing freedom and against the hypothetical world that some of the coal industry critics have presented to you of 15-percent increases compounded and pretty soon you get a really large number, I simply present the record, and the record is one of modest increases which on constant-dollar basis mean that coal shippers today are paying less than they were in 1980.

Finally, let me close, Senator, by saying that we at CSX are deeply concerned about the state of the export market. We are anxious to do all we can to assist in making U.S. coal more competitive in the world market.

Our president, Paul Funkhauser, last week gave a major address on that question, calling for an end to the acid rhetoric which has characterized rail-coal relationship and suggesting that it is time that we put that rhetoric aside and work for the common objection of making U.S. coal more competitive in world markets.

Thank you.

[The prepared statement of Mr. Snow follows:]

Statement of John W. Snow

Senior Vice President - Corporate Services

CSX Corporation

Before the Subcommittee on Energy and Mineral Resources

Senate Committee on Energy and Natural Resources

November 15, 1983

Mr. Chairman, my name is John Snow. I am Senior Vice President-Corporate Services of the CSX Corporation, the parent company of the Chessie System Railroads and Seaboard System Railroad. Our two railroad subsidiaries, which produce 92% of CSX's revenues, operate on 27,000 miles of track, serve 22 States, and have approximately 57,000 employees.

In your invitation to testify at these hearings, you said that they would focus on the competitiveness of American coal in the domestic and international markets, and the effect of recent legislative and regulatory actions on the movement and use of coal.

More than 30% of the revenues of the CSX railroads come from coal. We consider ourselves to be a part of the coal industry. As coal prospers, so do we. If coal is not produced and sold, we don't move it and don't make a penny. I state this simple proposition at the outset, because in recent months, there has been considerable acrimony about coal rates and railroads, some of it coming from our best customers, the coal producers and the utilities. Without the traffic they produce, we could not long survive with any level of return on investment.

CSX welcomes this opportunity to testify today along with other coal-hauling railroads to put the situation as to coal rail rates in perspective. We support the Staggers Act and the ICC actions which have resulted from it. My testimony will first give a general overview of the results that the Staggers Act has had on our coal rates generally and then give our views on the state of the export coal market. The second half of my testimony will focus on the Chessie System Railroads, which handle the bulk of our export coal shipments.

Let me review some figures which will give you a clear sense of the importance of coal traffic to the CSX railroads. In 1982, the Chessie carried nearly 96 million tons of coal which originated at points served on its lines. Of this amount, 29.4 million tons was for the export market. If we include coal received from other railroads onto Chessie lines, total coal handled was 118.3 million tons. Coal is the largest single commodity handled by the Chessie, comprising 54% of total traffic in 1982. One out of every two carloads originated on Chessie is a carload of coal.

The story for Seaboard is much the same; while the tonnages are smaller, the importance of coal to commodity mix of Seaboard is just as great. Coal originated on Seaboard in 1982 totalled 64.1 million tons, or 25% of all cars originated. Including received as well as originated traffic, coal makes up 26% of Seaboard's total revenues.

In discussing the effect that the Staggers Act has had on coal rates on the Chessie and Seaboard, it is well to remember that there are four provisions to consider: the cost recovery index, rate flexibility, (about which you will have heard a great deal from coal shippers and utilities), the virtual elimination of traditional rate bureau activities, and the right of railroads to enter into contracts with shippers (about which you may not have heard so much). Taken together, these provisions have given the railroads greater freedom to act without regulatory restraint, but at the same time forced us to respond to the market. Two significant things have happened on Chessie and Seaboard: neither has taken anywhere near the full amount of allowed rate increases and both have entered into contracts with an increasing number of shippers. The result has been that the Staggers Act is being used in a way which reduces, rather than raises, the rates for coal carried by the railroads.

Carriers are now permitted to recover inflationary cost increases on a quarterly basis. The cost recovery provisions of the Staggers Act outline the methodology for calculating these increases. The first increase in coal rates using the cost recovery index was in June, 1981. From that time until the present, a combined increase of 22.6% has been authorized on coal rates.

In addition, the rate flexibility provisions authorized increases over and above the cost recovery increase. To date, railroads could have raised rates an additional 18% beyond the cost recovery increases. Because of market constraints, the Chessie took only a 3% increase on domestic shipments in 1981; and none of the increases allowed under the rate flexibility provisions have been applied to export coal since the passage of the Staggers Act. The Seaboard in 1981 applied a 3% increase to all coal traffic and in 1982 took another 3% increase on some single-line traffic movements. However, some coal rates were actually sharply decreased in 1982. Rates from Eastern Kentucky and some Tennessee mines for coal going to CSX destinations in the North and East were cut by 20%. This reduction was a direct response to competition from another railroad. So the increases were far less than the theoretical maximum of 18% which would have been allowed by the Staggers Act.

It is particularly significant in view of the fears expressed about what will happen to rates for export coal under the proposed exemption from regulation, that Chessie has not taken a cost recovery increase or any other type of increase on export tonnage since January, 1982. In other words, the export rate has been frozen since January, 1982. For export coal moving through privately owned piers, it has been actually reduced.

If we combine the increases authorized by the Staggers Act under both the cost recovery and rate flexibility provisions, the railroads could have increased rates by 46% on a compounded basis since October, 1980. On an annual basis, this would have meant an authorized increase of 15.8% a year. But on the Chessie System rates for the transportation of coal have resulted in increases of only slightly more that half the authorized increases. From June, 1981, to the present time, coal rates on the Chessie have been increased on a compounded basis by 24.8% or 9% on an annualized basis. In similar fashion, the Seaboard has used only a portion of the rate flexibility increase it could have taken. In 1982, for example, while the combined authorized increases would have allowed a 10.7% rise in rates, published tariffs were only 7.2% above 1981. If we included rates negotiated under contracts the overall rate increases for all coal shipments would have been much lower.

The figures I have cited relate to the published tariffs for coal. The increased use of contracts by both Seaboard and Chessie is resulting in coal rates which for the most part are lower than the published tariffs. The rate flexibility and cost recovery provisions have not given the railroads the ability to act unilaterally. They have given both railroads and their shippers the incentive to meet in the marketplace and to negotiate contracts. There are genuine economic incentives for both railroads and shippers to enter into these contracts--for railroads, they offer assured volumes of traffic and revenues, encourage the efficient use of equipment in unit trains, and allow us to plan our equipment acquisitions and capital expenditures; for shippers, contracts bring about lower rates through better equipment utilization and the use of shipper-owned equipment, and they also assure stability of rates and service.

For coal shippers on both Chessie and Seaboard, the use of contracts is steadily increasing. Seaboard currently has 41 contracts in place which account for approximately 27 million tons annually or 45% of all originated traffic. In addition, Seaboard participates in 19 contracts in combination with the Chessie. Even beyond the reduced rates offered under these contracts, the Seaboard has also limited its ability to take revenue adequacy increases on the majority of its signed contracts. As a result, Seaboard is now transporting substantial volumes of coal at rates lower than those that were in force prior to the Staggers Act (on a constant dollar basis).

The Chessie System has already concluded contracts covering the annual movement of 39 million tons of coal. It is presently negotiating with customers for an additional 61 contracts for the movement of 21 million tons of coal.

So it can be seen that larger and larger volumes of coal are being covered by contracts, with the benefits they bring to both railroads and to shippers. Let me give you several examples of what these contracts can mean. The Chessie and Seaboard have joined in an agreement with Virginia Electric and Power Company (Vepco) that will save the utility up to $7 million a year. By a combination of published tariffs and contracts, Chessie has dramatically reduced coal rates to privately owned coal export piers in Newport News and Baltimore. Rates to these piers have been lowered by almost 20%. Since published export rates have only been increased a total of 21.3% since 1980, Chessie has virtually reduced export rates to these private piers to a preStaggers level. And Seaboard has recently announced a contract with a State-owned utility in South Carolina which will reduce that rate from $14.19 a ton to $11.80 a ton. The new rate was made possible by the use of a new type of all aluminum hopper car to be purchased by the utility; this lighter weight reduces maintenance costs for the right of way. Using the contract authority, the railroad, the car supplier, and the utility were able to work together to use new technology to bring about a lower rate. These are but a few examples among many which would demonstrate that the regulatory freedom of the Staggers Act has allowed railroads to work with their shippers to develop new and better service.

In discussions of the Staggers Act, much has been made of two ICC actions affecting coal--the coal rate guidelines and the exemption of export coal rates from regulation. The actual results in the domestic market of rate actions taken by the Seaboard and the Chessie since passage of the Staggers Act are a factual answer to the theoretical fear that railroads might increase their rates by 15% a year. It has to be emphasized that the 15% guideline suggested by the ICC is not mandatory or automatic, as some would seem to suggest when they project gigantic increases in coal rates. We do not think that the 15% guideline is necessary, not because we seek an unlimited power to raise rates, but because market forces would not permit anything like such an increase. Critics of the Staggers Act have attempted to turn an unrealistic and theoretical ceiling into an actual fact. If competitive forces are at work on domestic rates, they are having an even stronger effect on export coal, where our overseas customers now enjoy the luxury of a buyer's market. The current state of the world market for coal provides ample justification for the ICC's finding that vigorous competition exists, and that this competition will be a more than effective constraint on coal rates.

As CSX's own earnings sadly reflect, the market for overseas coal is not good, and is expected to remain flat through 1984. CSX's exports of coal for 1983 are expected to be between 24 and 26 million tons, and we foresee only a slight increase for 1984. What we are seeing is a temporary turn downward in what is really a new market for U.S. coal. The new market for steam coal, which showed such a dramatic increase in 1980 and 1981, was created by external events which had nothing to do with railroad rates - the sharp increase in oil prices and the collapse of Polish coal production. Steam coal exports to Europe went from 1.3 million tons in 1979 to a peak of over 20 million tons in 1981 and 1982.

You are well aware of the results of this unexpected, 2,000% increase in coal exports: the huge lines of ships waiting to load at Norfolk and Baltimore harbors. This sudden, new market was responded to by the railroads and American coal producers. New port capacity was added and planned for the East Coast and efficient arrangements for the orderly loading of ships were created. With equal enthusiasm, projections for the future of coal exports went straight up. The freshly baked pie was going to get even bigger.

But the unusual economic factors which had brought about the new market shifted with equal suddeness. World-wide recession reduced demand for coal in Europe. Polish coal production increased and the Poles re-entered the market, willing to sell coal at almost any price to earn foreign exchange. And the value of the U.S. dollar continued to strengthen; in the the past three years it has increased more than 80% against the French franc and the Italian lire. As a result, steam coal exports to the European market for 1983 are expected to be between 13 and 14 million tons.

This decline from the high levels created by a series of unusual circumstances is discouraging, but it must be set against the almost negligible level of steam coal exports that existed prior to 1979. Even in the present bad economic climate, we have maintained 30% of the market for steam in Europe. And world-wide, our total coal exports, both steam and metallurgical coal, in 1983 will be approximately 300 million tons as contrasted to the pre-1979 level of 220 million. The "energy crisis" has settled into permanence and created a long term market for U.S. coal. I don't think our view should be thrown off by temporary declines caused by economic conditions or by the re-entry of traditional competitors into the market. Nor do I think that rail rate should be singled out as the one cause of the failure of U.S. coal exports to reach unrealistic heights. The fact is that the U.S. has captured, and will continue to hold, a substantial share of the export market. We expect that we will hold on to this market share and that the amount of coal exported will increase as the world economy grows.

It is important to remember one fact that all observers agree on: on a dollar for dollar basis, U.S. coal can never be competitive with Polish or South African coal in Europe nor with Australian coal in the Far East. And this competitive disadvantage does not stem from rail rates alone. The delivered price of United States coal in the European market is $10-12 a ton higher than coal from competitors. This disadvantage commences at the minemouth. For example, our information indicates the estimated price of Appalachian coal at the minemouth to be $21 to $24 a ton compared to $17-$18 a ton in South Africa. Polish coal, of course, is being sold at almost any price and obviously does not involve the transportation costs of U.S. or South African coal. But the U.S. does offer a stable source of supply of high quality coal. Our overseas customers, who wish to diversify their energy sources and who experienced the consequences of the near shut down of Polish production a few years ago, are willing to pay some premium for U.S. coal, because of our stability as a source.

In the near term, U.S. coal exports present a discouraging picture. But we think that long term growth will occur and we intend to participate in it. CSX has taken positive steps to encourage the continued growth of coal exports.

--rates have been reduced for coal moving over privately owned piers;

--because of the competitiveness of the world market, the Chessie System has not increased rates on export coal since January, 1982;

-- we have worked with coal producers to increase export capacity at ports served by the CSX railroads. The Chessie piers at Newport News and Baltimore and the Seaboard piers at Charleston, Mobile and Alabama State Dock have a combined capacity of 108 million tons. That capacity will be nearly doubled if planned construction and expansion projects are completed at these coal ports. The Chessie System alone will have available through its own piers and privately owned piers, either now in operation or under construction, an annual export capacity of 90.5 million tons.

And, finally, we believe CSX's proposed acquisition of American Commercial Barge Lines will, through the efficient coordination of barge and rail lines serving the coalfields, particularly those in Western Kentucky, open up new export markets for U.S. coal.

In conclusion, Mr. Chairman, let me reaffirm the CSX railroad systems' commitment to expanding the export of U.S. coal. The coal hauling railroads have just as much at stake in seeing the overseas market grow as do our partners in the coal industry. We believe that the Staggers Act has worked well in the domestic market, as the steady growth of coal moving under contract demonstrates. We would welcome the opportunity to enter into long term contracts with domestic producers and overseas buyers to assure the long term supply of coal at a stable price. We think that the export coal exemption will encourage the use of contracts, which have not been widely used in the export trade, and thus improve the prospects for coal overseas.

At CSX, we think it is time that all of us in the coal industry set aside the present war of words and worked together to find ways to increase the export of U.S. coal--recognizing the fact that the U.S. will always be the high-priced supplier and that no part of the chain of production and distribution of coal can be singled out as the sole cause of the price differential. The President of CSX, A. Paul Funkhouser, has suggested that a blue ribbon panel be formed with representatives of the railroads, the coal producers, the mine workers, and the Federal and State Governments to explore practical ways in which costs could be cut. We believe that such a blue ribbon panel could have positive results in finding cost savings which can be passed along to the customers overseas. Railroads cannot be expected to do the job alone. But we stand ready to work with the other participants in the coal industry in a partnership for greater coal exports.

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Senator WARNER. Mr. Snow, could you touch on the issues raised this morning with respect to the small coal operator? Under the Staggers Act, rails have the right to enter into and negotiate contracts with shippers. These contracts have been pointed to today as a way to lower coal prices.

However, testimony also pointed out today that a small coal operator because of his size is unable to avail himself of the contract provision—just pure leverage.

Mr. SNOW. Senator, our rates are lower with contracts to small shippers as well as large shippers, and as Mr. McKinnon has pointed out in his testimony, an awful lot of small coal shippers operate through transshippers who are quite large and those transshippers have a great deal of market leverage over us.

We have embarked on a program to make contracts available to small shippers and to encourage them to use unit trains. Only some 25 percent of our traffic moving export moves on unit trains. In South Africa it is 100 percent. If we can get the economies of unit train movement, we can lower coal rates to export and get a larger share of that market so I am certainly aware of the concern on that score, but I think we have been responsive to the need of small shippers as well as larger shippers, and the market is making us responsible.

Senator WARNER. Mr. McKinnon, you have worked with a number of small shippers. Do you wish to add to that?

Mr. MCKINNON. I agree with what Mr. Snow has said, Senator. I would also say that we are prepared to and have entered into various sorts of service contracts with smaller shippers. We had one group of contracts that was designed for those who could not ship in as big a volume as some others.

Beyond that, as I indicated, we have tariffs today, with the exception of tariffs are no longer in effect on export coal, but what are comparable to tariff rates, we have on those not put in the cost-recovery increases just as we have not done on the contracts.

Mr. SNOW. Senator, could I add one thought on that? At the time when the export market is off by some 30 percent, our Great Lakes market is also off. It is off by 10 percent, but our share of that market has gone up. It has gone up because of contracts. Our iron ore business is up 70 percent in the face of an overall decline of the market. Our coal business is up 30 percent in the face of an overall decline. A great number of those shippers are small shippers, and the reason our market share is up is contracts, so it seems to me contracts are the answer with small shippers as well as large shippers.

Our experience indicates that smaller shippers as well as larger shippers benefited from contracts.

Senator WARNER. In my opening statement and in questions to the first panel I pointed out that a substantial part of your rolling stock was idle, and the commensurate part of your personnel probably laid off in one way or another.

Is that a factor in this decision or an indicator of any aspect of the problem?

Mr. MCKINNON. I think, Senator, it is an indicator that the drops in the coal market affect us as well as the coal producers, and generate concern on our part. Norfolk & Western had over 50 percent of its revenues in 1982 derived from coal. Those revenues have dropped. It is the reason that we have taken the market action we have taken which we think has been appropriate. There is a point below which if we cut our rates we would become even more——

Senator WARNER. That would be the follow-on question. Have you determined rates beyond which you cannot go below even if it would bring back utilization of that rolling stock and that employment?

Mr. MCKINNON. We make a real effort to do that, and there have been cases, and we have done this under contracts, where we have looked at opportunity for movement of coal which would not otherwise move, maybe not move even from this country, where we have given specific quick rate adjustment to make that coal move, but it is a fine tuning. It is more art than science, but it is the effort that we make in all of our ratemaking actions.

Senator WARNER. Some segments of American industry are literally operating without a profit. Have you considered that in some instances?

Mr. MCKINNON. Well, we don't think that it is our duty to try to operate without a profit for our shareholders. We have definitely had our profits very substantially reduced, and our return on Norfolk Southern for 1983 is down in the area of investments in the area of 5 percent. With the cost of capital at 17½ percent, you are not operating at a true economic profit in that circumstance.

We have a bottom line income, but it is in return on investment in comparison with other industries that is still quite a little return.

Senator WARNER. Mr. Snow, do you have any comments on idled rolling stock and unemployed rail workers?

Mr. SNOW. In 1980, we had some 70,000 employees. Today we are down around 55,000 employees. We have suffered, and suffered seriously with the current economy and with the coal outlook.

Senator WARNER. What percentage of rolling stock is idle now?

Mr. SNOW. Oh, I would hesitate to say on that, but we have a number of, we have 1,000 locomotives in storage. We have thousands of hopper cars in storage. What percentage I couldn't say, but it is a significant percentage, and as I say, our employment is down 20, 25 percent, so we have been grievously affected by the current conditions.

We are always looking at the question whether rate reductions spur the market, whether our rate reductions lead to enough traffic to justify the rate reduction, recognizing that often if you make a reduction over here, you have got to make it here.

Our coal export is 20 million or so, down from 35 last year. We have 200 million tons of coal originated, a $2 reduction on the 20, which leads to a $1 reduction on the remaining 180, which puts us without any net-income, so we have to watch the whole net-income picture when we make reductions, and the other side of making reductions is what do we get for it? Can we hold the market share? Can we get any additional traffic?

I cited the Great Lakes example. We made numerous efforts with the Europeans to encourage them to enter into long-term contracts which have not been available. Unlike our steel shippers, the people in the Great Lakes I referred to that made possible that strong market there in the face of a declining overall market have been unresponsive to contracts, and I think it is because they continue to view the U.S. market as essentially a search party. They continue to view it essentially as a spot market to be used when they have additional needs they didn't anticipate or to keep in the market, but it is not the baseload for the Europeans, and as long as they view us as their search party to meet incremental needs and aren't willing to enter into contracts, we question how we can penetrate that market and get a larger share.

We need a better dialog with the Europeans about their use of U.S. coal and entering into contracts with us, and in response to contracts, we are prepared to talk reductions, but we don't get much responsiveness on the contracts.

Senator WARNER. Mr. Ford.

Senator FORD. Mr. Chairman, let me ask Mr. McKinnon a question or two. You said that you worked very hard to help one of the witnesses in the previous panel, I think I am correct, in his efforts to open a closed mine? Is that correct?

Mr. MCKINNON. Yes, sir.

Senator FORD. Was that for export?

Mr. MCKINNON. That was for domestic. That was for a movement to New England.

Senator FORD. Now you said that, you said a lot of your shippers, you relieved them of their shipment requirements?

Mr. MCKINNON. Yes, sir.

Senator FORD. Did you reduce the rates?

Mr. MCKINNON. Except for the rate reductions I have mentioned, we didn't reduce the rates further. There would have been substantial liquidated damages to which we would have been entitled if we had enforced the contracts. We, of course, made the contracts on the strength of commitments of substantial volumes. It was apparent they couldn't meet those volumes despite the fact the contracts called for them to meet the volumes or pay liquidated damages. We said this is the condition that we recognize the marketplace has pushed us, pushed you, and we are not going to try to take the pound of flesh.

There were no other rate reductions in those particular changes other than the failure to take the cost recovery increases.

Senator FORD. Can you give me one instance where you have reduced the rates?

Mr. MCKINNON. Yes, sir. When we have not—we, in virtually all of these export contracts, have provisions in them that if the cost-recovery index went down, we would reduce our rate. The cost-recovery index went down in April of this year. I think again in July is my recollection, and in both of those cases, and this covers 85 percent of our export coal, the existing rate automatically went down.

Senator FORD. On page 4 of your testimony——

Mr. MCKINNON. Senator, let me add to that. These contracts now are all confidential so I have to be careful in how I discuss this, but I mentioned the contract for an export movement that probably would not have moved out of this country if we hadn't reduced the rate. We reduced the rate substantially. It was a new contract, but it was substantially below the published tariff rate.

Senator FORD. That was in the newspaper, wasn't it?

Mr. MCKINNON. Perhaps it got in the newspaper. It was supposed to be confidential, but I had 15 other customers call me up within 2 days of the time we made the contract to ask about it, and I expect it got in the newspaper.

Senator FORD. Welcome to Congress. On page 4 you have a statement, you said, "Nevertheless, our rates of return remain lower and our ability to compete particularly in the export coal market has been impeded in several respects by continued regulation." You say the Staggers Act, before that, was an important step in improving the financial health of the railroad. Now within that same paragraph you say "has been impeded."

What do you mean by that?

Mr. MCKINNON. Senator, impeded may not have been an appropriate choice of words, but I think it was. We have found since the coal-exemption proceeding that we are able to respond more quickly on some of these needed marketplace changes and contracts than we were even under the contracts. Staggers lets us enter into contracts, but for example, when we were making these changes that involved the elimination of liquidated damage, we had to file some fairly extensive petitions to the ICC to get them to agree that this was in effect not an illegal rebate, that it was an appropriate adjustment which would not be a rebate under the old Interstate Commerce Act. Since we have had very few changes since the September exemption case—we have had a change, I can think of two in the last 10 days with a major transshipper where the contract provided for movements of coal from only a limited group of mines on the North & Western system—by simple exchange of letters which we didn't have to file anywhere we expanded that contract to permit the inclusion of coal coming from Southern Railway origins in Virginia.

I don't know that these particular ones covered Kentucky but we were prepared to do the same thing, but all we had to do at that point was simply file, write a letter between us and that is the kind of added freedom that we have gotten already from the exemption.

Senator FORD. On your last page, page 8, you say: "Between 1960 and 1979, average rail rates on export coal increased 294 percent, while coal prices during the same period were rising at 811 percent." That is between 1960 and 1979.

Mr. MCKINNON. Over a 20-year period.

Senator FORD. Tell me about 1980 through this half of 1983.

Mr. MCKINNON. OK, sir. Now the coal increases, and the great bulk of these came in 1981, in the last 3 months of 1980 in the ex parte provision——

Senator FORD. You left out when we had the accelerated export?

Mr. MCKINNON. Those particular figures, that's right.

Senator FORD. You left out the accelerated export?

Mr. MCKINNON. I covered the 20-year period, but since that time, Senator——

Senator FORD. You left out up to the Staggers Act?

Mr. MCKINNON. Yes, sir. Since Staggers, in the last 3 months of 1980, there was an ex parte increase of 5 percent which was, in part that was one of those where the Commission folded in cost recovery and whatever else they folded in.

Then in 1981 there were a total—that was when we all had the oil prices going up, when we and the power companies were both having to increase our rates because with the passage of energy costs there was a total 8.4 percent in cost-recovery-related increases, and then there was on December 1, 1981, a 3-percent revenue improvement increase. That is the one I mentioned, the 3 out of the total 18 we might have taken. That made a total of 11.4. In 1982, the total increases, and this included cost recoveries, we had a 4.7-percent increase on January 1, and then with the holddown in inflation, that was the only one in 1982.

In 1983 we would in net have been entitled to 1 percent. We have not taken that on export coal, but that is a total of 19 according to my figures, for a cumulative total of 19.1 percent in general increases and 3-percent revenue improvement increase, and I say virtually all of those were cost of recovery increases.

Senator FORD. The 22-percent increase, when you say that is a cumulative total of 22 percent, that is 10 this year and 5 the next year and 7 the next year?

Mr. MCKINNON. It happened to be 5 one year, 10 the next and 4 the next, but that is what it is.

Senator FORD. When you take 11 percent and you take 4 percent on top of the 11 percent and multiply that out, it is not a flat 19 percent.

Mr. MCKINNON. No, sir. It is a cumulative increase.

Senator FORD. Based on percentage, what would the real increase be? You talk about the cost in real dollars. What is the real increase?

Mr. MCKINNON. I don't have that figure, Senator. We can get it. It would be something more than the 19 on the export coal as opposed to the domestic. As I mentioned, you had cost-reduction provisions in the contract which moved that coal, and those are not reflected here, but those would also have been a reduction in a cumulative, on a cumulative basis.

Senator FORD. When was that massive 22-percent increase that came, that fell on the producers all at one time? Was that before the Staggers Act?

Mr. MCKINNON. Senator, that was, as I recall it, before the Staggers Act. I have to say that increase was not initiated by my company, and I think you might recall it was largely on coal from a competitor, and on our own internal movements we didn't put that increase. We had some joint rates, but we didn't have that one, but my recollection is that that was just before the passage.

Mr. SNOW. In 1978 I think, Senator. That was the L&N action in 1978.

Senator FORD. You have acquired the L&N?

Mr. SNOW. That's right, Senator.

Senator FORD. Is it still an entity within your organization?

Mr. SNOW. No. It has been merged with Seaboard.

Senator FORD. It is no longer L&N?

Mr. SNOW. That's right.

Senator FORD. Let me ask you this then. Have you initiated I guess layoffs because L&N is no longer an entity?

Mr. SNOW. No, Senator. The L&N is operating the same routes and same yards and the same, essentially the same way it did prior to the corporate simplification which was the basic reason for the merger. We had a confused situation with the name called the Family Lines, and we thought that for marketing purposes one name, the Seaboard System, made more sense.

Senator FORD. In the statement that the chairman read a few moments ago about double, triple, and quadruple in the rates over a period of time, would you say that that statement is correct if you keep on doing what you are doing now?

Mr. SNOW. Senator, if we keep on doing what we are doing now, our rates are going to keep going down.

Senator FORD. Keep going down?

Senator WARNER. In real dollars.

Mr. SNOW. In real dollars; they will be lower in the future, Senator, and we have entered into—one of the dramatic and remarkable things about Staggers is contracts. Today some 30 percent of our traffic is under contracts. Invariably those contracts were entered into at rate reductions over what the tariff rate was and with provision that you don't take any revenue enhancement in the future, that you live by the inflation index or in many cases by only a portion of the inflation index, so that our shippers, if the coal market comes back as we hope it will, we are not going to be able to participate.

Senator FORD. It will only come back if the economy improves?

Mr. SNOW. That will certainly help, Senator, yes.

Senator FORD. Mr. Chairman, I don't have any further questions.

Senator WARNER. The vitality of those coal companies is essential to your business?

Mr. SNOW. Absolutely, Senator.

Senator WARNER. We heard a very serious indictment this morning. What you are saying is that it is the market situation as opposed to the transportation situation and you can justify that by facts which show that your rates in terms of constant dollars have gone down? Is that a succinct summary?

Mr. SNOW. That is a succinct and accurate statement, Senator.

Senator FORD. Well, let me ask you this. If their rates go down in real terms, what happens to the coal producer compared to real dollars? Where is his profit?

Mr. SNOW. Senator, I think the coal producers—I shouldn't speak because I don't know accurately—but I think their rates are also down in constant dollars, and could well be below in real-dollar terms the price they had in effect in 1980.

The other side of that, though, is that in the midseventies when rail rates were constant, relatively constant, and coal rates were going through the ceiling, railroads weren't invited to that picnic. We weren't at that party. We didn't participate in that explosion in revenues, and that is the other side of the coin, the fact that historically coal rates, coal prices have fluctuated; rail rates have been relatively constant. In the good times railroads haven't participated in the enormous profit that the coal companies have made.

Senator WARNER. Because of regulation?

Mr. SNOW. Well, I think it was the pricing policies of the railroads.

Senator FORD. The Staggers Act gave you some freedom there, John.

Mr. SNOW. Yes, Senator.

Senator FORD. Freedom that you didn't have in the seventies.

Mr. SNOW. We have got more pricing freedom by far that we had in the seventies, but I will stand by the statement that it is a competitive market, and there is very little unexercised market power that railroads have over any shippers, and therefore, there is no reason to expect railroads to take unreasonable increases and to take unreasonable increases, as Mr. McKinnon suggested, is not in our interest because to do so shrinks our market.

Senator FORD. You know, I love you all, but I walked the rails. You know, I went back to the mines. I talked to the operators. I talked to railroads, and you understand some of the problems I had, and you have improved upon it, and I compliment you for that.

There is no question but what we are better off in rail transportation in Kentucky today than we were before you arrived, I say that publicly, and will sign it, you know. But on the other hand, when you take an individual who is producing coal and he has to buy his own switching engine, he has to pick up the cars, he has to take the coal up and load it, take it back to you, that is subsidizing your rate. Then when he is sitting there with coal on the ground and sold at that time and he couldn't get anybody to come and get it and you wouldn't go single car for a little operator, it had to be unit trains—and I got burned pretty good by trying to help you with unit trains, and I say this lovingly, I have been through this thing. It is not any picnic for me, and I am for you one day and against you the next. You know where I come from.

Mr. SNOW. Very impartial.

Senator FORD. That's right. I'm going to fight for that little operator down home, and as I say, I think you have improved the situation considerably, but it does seem to me that when an operator is required to do these things he is subsidizing whatever you get.

I have seen them buy cars, and when they put it on the train, when the railroad cars are available they come back for that poor operator's car sitting on the side down there, and they may not come back for weeks.

Now you talk about fair. Here he is paying all that cost of buying the car, buying the switching engine, and then when his car needs to come back you can't service him. His cars are still down there. You are taking care of yourself.

Charity starts at home. I was taught that at an early age, and I agree with that, but then we all hear fairness here this morning. Be fair. Sit down. Work it out with the operator and the shipper and all that. You do sit down and work it out. Like Getty said a few moments ago, that would be wonderful except that poor fellow doesn't have but one way out. We play football along a 70-yard field in eastern Kentucky. How do you think we are going to get out? This is going to get tough.

I've said all I need to say and probably more. It is in my gut about some of these things, and I think we are beginning to move in the right direction. I certainly hope that we can pass my bill, and I encourage all those who think that a little bill for the Staggers Act is right will give us some help. I think the pressure ought to be put on to the administration if they are going to replace the members at the ICC, and I am beginning to think they are not. I think they want to see that Commission go down the tubes. I see that coming, and I make that out here not a smokescreen, but as a fact, and we need to make some—if it is going to be fair, let it be fair for the goose and fair for the gander.

Senator WARNER. One further observation—as I have come to learn the vagaries of this industry over the 2 years I have been on the committee, it seems to me that we just have brief windows of opportunity to reach into this export market, and it has been closed for years. It isn't as if it is up for renewal every 30 or 60 days, but these contracts, the more desirable ones that provide some stability to your marketing, occur with some infrequency, and here we sit today in free and open discussion. I am not feeling any sense that we are approaching a point of resolution absent going to the ICC and perhaps giving them additional regulatory statutory power. The Government has to solve it.

I am always reluctant to turn to the Government for solutions, and yet if we don't and lose those long-term export markets, everybody is going to suffer.

We should allow the other two members to speak, Mr. Ford, and I am at fault for not giving them the opportunity to talk.

Mr. Hertog, why don't you provide us with your wisdom on this issue?

STATEMENT OF JOHN H. HERTOG, SENIOR VICE PRESIDENT, COAL AND TACONITE, BURLINGTON NORTHERN RAILROAD CO., ST. PAUL, MN

Mr. HERTOG. Thank you very much, Mr. Chairman. I promise to try and give my oral comments as succinctly as possible.

I have offered a written statement for the record that I would hope would become a part of the record and hopefully will contribute to the very important subject that you have under discussion here. The views I am going to cover briefly are those as we see it from the vantage point of Burlington Northern Railroad, which as you know, serves the West and basically the Powder River Basin coal area which is the largest of the coal-producing areas that we serve.

I want to hasten to add, however, there are several other smaller areas that we serve, and generally the comments I am going to make apply to those areas as well.

At the outset, let me explain that we have not participated, unfortunately, in the export market to this point in time. All of our business, 100 percent of it, is associated totally with the domestic market, and I think there are three basic reasons why.

Thus far at least the export market has not been one that we can serve. No. 1, the furthest mines to the West, that is, the closest to the sea, is approximately 1,220 miles from the nearest port, that being Portland, OR. Compare that with Utah, for instance, where the producer is 850 miles from the Port of Los Angeles and Long Beach.

Second, the coal we serve is of lower quality. The Btu per pound ranges between 80 to 100 and about 9,000 as compared with the Utah coal which has a Btu capacity of 10,500.

And last, there is no port in the Pacific Northwest in the United States that Burlington Northern serves that has the capability to transload coal from rail cars to seagoing vessels, and so even if the business were available at this point in time the capability does not exist. The Port of Long Beach and the Port of Los Angeles, on the other hand, are two ports in the State of California that have that capability.

Those are real factors, and each of them involves an economic set of terms in themselves all of which I think are responsible for the fact that to this point in time, there is no export market that we can serve, but coal, nevertheless, is big business on Burlington Northern. It represents about 60 percent of our total transportation product in terms of the ton miles of transportation we provide, and about 40 percent of our revenues. This year we expect to haul about 130 million tons of coal, the bulk of which goes to utilities for the generation of electrical power.

There are some 41 utilities we serve in some 20 States. The hauls are very long. They average 800 miles, the longest being about 1,700 miles one way. The utilities are served in two-thirds of the cases either by other railroads other than Burlington Northern, or other water carriers, and so what we have got is not a one-man show by any means, but a true cooperative venture involving several other carriers, including water carriers on the Great Lakes and water carriers on the inland waterway system.

About 95 percent of all coal moves by unit trains. Unit trains are the most efficient means of delivering the transportation, at least the most efficient means we have been able to devise to this point in time. We made a very substantial investment in the coal business over the last 10 or 12 years, and we have seen our business happily be the kind of market that has been growing and not declining as we have heard some of the comments today, growing as a matter of fact to the point where it doubled from 1973 to 1977, doubled again from 1977 to 1980, and it has grown another 25 percent this year as compared with 1980.

Our coal rates average about 15 mills per ton mile or about 1½ cents per ton mile. Let me express that in a little different fashion. Our average unit train coal rates for moving 1 ton of coal 100 miles are $1.50, so I would submit to you that you would have to go a long way to find anybody willing to haul a ton of anything for 100 miles for $1.50.

Now we have been able to do that by virtue of the fact that the bulk of tonnage moves in unit trains, that the unit trains are big trains. They carry a lot of coal, and they are in fact as efficient as we can possibly make it, but it is only because of that that we have been able to provide those kind of rates.

Compare that, for instance, with the rates on all other commodities that we move at least, that amount to about 2.4 cents and not quite double, but almost double the average rate for a coal train, and I think that certainly believe the development of markets for the Powder River Basin coal has been the result of a multiplicity of efforts—producers being able to produce the coal at very low cost, users being able to adapt the use of that coal in very efficient plants. Certainly an important ingredient has been the ability that we have developed to provide a transportation system that truly is in some respects unique and clearly very efficient.

We are certainly disappointed that coal markets aren't growing further. Based upon all the projections that we have looked at, we fully expected that they would, but I don't think that the reason they are not growing can be laid at the doorstep of the railroads, and specifically the railroads in the West, for having fostered rates that are unreasonably high.

Frankly, the market simply is not there. We have had to look realistically at the fact that there is much slower growth, things like the Clean Air Act, and the extent to which they might require the use of more low sulfur coals could be factors for the future to consider.

As we have gone through this period of growth, we unfortunately have had some disagreements with several of our customers with respect to rates. Many of those have been resolved through the use of contracts, and we like Mr. Snow's company now have about 30 percent of all of our coal transportation under basically long-term transportation contracts. We are in the process of negotiating many more, and I am convinced that to the extent to which there is litigation either before the Commission or the court with regard to coal rates, that those remaining disagreements are going to be resolved in a fashion that both we and our customers can live with.

I guess one of the other requirements in the Staggers Act that I think is quite significant and one we have taken very seriously is the responsibility to operate our property in an efficient manner because it is only if we operate it in that fashion that we are entitled to the benefits of the Staggers Act. We have worked very diligently I can assure you to reduce our costs, to improve our service, and to create in fact the kind of environment that will give us the most efficient system possible. We are proud of it, and we are going to continue to work to make it even more efficient.

Thank you.

[The prepared statement of Mr. Hertog follows:]

STATEMENT OF

JOHN H. HERTOG

SENIOR VICE PRESIDENT -- COAL & TACONITE

BURLINGTON NORTHERN RAILROAD COMPANY

BEFORE THE

SUBCOMMITTEE ON ENERGY & MINERAL RESOURCES
OF THE SENATE COMMITTEE ON NATURAL RESOURCES

NOVEMBER 15, 1983

My name is John H. Hertog and I am Senior Vice President of Coal & Taconite for Burlington Northern Railroad headquartered in St. Paul, Minnesota.

I am pleased to have the opportunity to testify at this hearings. A sound railroad system provides an indispensible linkage between coal production and coal consumption, so your stated focus on the impacts of recent rail deregulation on the coal industry is appropriate and important.

My perspectives today will be mostly confined to Burlington Northern Railroad and our involvement in Western coal transportation, chiefly from Montana and Wyoming.

Coal is a very important commodity for our railroad, accounting for about 60 percent of our ton-mile volume and 40 percent of our revenues. This year we expect to haul about 130 million tons of coal, over 90 percent of which comes from mines in the Powder River Basin of Montana and Wyoming. We also serve mines in Illinois, North Dakota, Alabama and Oklahoma.

Almost all of our coal shipments are to electric utility companies. We are moving coal to some 41 of these companies in 20 states, with some of the movements traveling over 1,600 miles from mine to destination. The majority of these movements are terminated by other railroads or water carriers.

Most of the coal shipments we handle are transported in unit trains. That is, 100 or more 100-ton cars plus locomotives that operate in dedicated service between the mine and the utility plant. As a rule, these trains bypass major terminals and load and unload in four to five hours. It is an extremely efficient form of transportation and, when combined with the economies of scale of the large surface mines in the Powder River Basin, allows this coal to reach major markets in the midwest, midsouth and gulf states.

The Powder River Basin contains the largest amount of strippable low-sulfur coal reserves in the country. In just over 10 years this coal's share of the U. S. utility market has risen from near zero to about 20 percent. Our part in this remarkable increase was to provide a low-cost, efficient transportation system to link the mines to major population centers throughout the country. We saw Powder

River Basin coal shipments double between 1973 and 1977 and then double again by 1980. And this year's shipments should be more than 25 percent above 1980's level.

At Burlington Northern Railroad we are proud of our crucial past and present role in facilitating the development and use of Powder River Basin coal throughout the country. It has taken over $1 billion in equipment and physical plant investment on our part alone and thousands of dedicated employees to bring this about. It has also required a high degree of cooperation by the mines, by the utility companies and by our connecting rail and water carriers.

In view of this, it is extremely disappointing and perplexing to us when the National Coal Association and others who should know better create a great public clamor about coal transportation rates being higher than the mine price of the Powder River Basin coal itself. It should be remembered that the price charged for producing the coal has nothing to do with the costs of moving the coal. Transportation costs are mostly a function of distance and regardless of the selling price of a ton of coal -- whether it is five-dollar coal or $25 coal -- the farther it is moved, the more fuel, labor, and other costs will be expended. Those costs would not change if the coal producer decided to double the sales price or to give it away free.

This is not to say that transportation costs have nothing to do with the coal purchase decision. Transportation, mine price, combustion cost and pollution control cost, are all important components of the fuel selection process. Powder River Basin coal, with its low heat values, faces intense competition from high BTU midwestern and eastern coals, as well as other western coals. It also faces tough competition from local lignites, hydro and nuclear power.

During 1982, Burlington Northern's coal rates averaged only 1.5¢ per ton/mile as compared to 3.1¢ for grain products, 3.7¢ for primary metals products, or the all-commodity average of 2.4¢. Our coal rates, on a ton mile basis, also tend to be lower than the national average for rail coal transportation. In the last year for which Association of American Railroads Statistics are available (1981), BN coal rates were 1.32¢ per ton mile compared to the U. S. average of 2.51¢. Looking at it another way, in 1982 we hauled on the average a ton of coal for a distance of 100 miles for only $1.50. I doubt that you can envision transporting a ton of anything that far for that little.

So, whether the comparison is to other commodities or other railroads, Burlington Northern unit train coal rates are eminently reasonable. Moreover, the fact that these rates permit Powder River Basin coal to move in ever-increasing volumes during these slow times to electric generating facilities nearly 1,700 miles from the mine is a pretty clear illustration of the soundness of our pricing structure.

Turning now to the overall current demand for coal, the mines we serve and our coal traffic have not been immune to the recent downturn. Despite the fact that Powder River Basin coal production has increased steadily, the mines could be producing -- and we could be transporting -- a good one-third more than what there currently is demand for with the capacity presently in place. Much as we would like it to be otherwise, the signs indicate that the unprecedented Powder River Basin coal boom of the 1970's will not repeat itself in the 1980's. The stabilization in OPEC oil prices, increased emphasis on conservation and a slowdown in electricity demand growth rates are causing the coal demand projections to take on a flatter pitch than previously cast. There will be growth, of course, but it will be relatively low and steady rather than spectacular.

We have also been disappointed in the diminishing promise of export markets for coal. Because of its low heat content, distance from water and lack of port facilities, Powder River Basin coal has thus far not been a strong contender for export.

A major imponderable at present is the impact, if any, of legislation for acid rain control. Two major modifications to the federal Clean Air Act now under consideration could have significant impact on the Wyoming and Montana mines we serve. A major sulfur dioxide reduction program that allows low-sulfur coal to be used to control acid rain and modification of the existing percentage reduction requirements for coal burning power plants could add substantially to the demand for Powder River Basin coal in the 1980's. Obviously, these are highly political issues and outcomes cannot be predicted. If the demand develops, I am confident Burlington Northern and the other western carriers with the western mines are equal to the task.

An important focus of these hearings is on the impact of the 1980 Staggers Act on the coal industry. This piece of legislation was enacted by Congress three years ago to try to remedy the alarming deterioration of the railroad industry. The condition of the railroad industry has a direct impact on the coal industry because most of this country's coal producers require a sound, efficient rail transportation system to move their product to market.

The Staggers Act allows railroads certain regulatory freedoms to at least attempt what to most industries would be elemental; i.e. an opportunity to earn their cost of capital. Railroads are not guaranteed any kind of return, merely some room to work out their own salvation. The Act mandates change and changes require adjustments and some discomforts. For our part, we have been better able, through negotiation or litigation to increase rate levels where such action was necessary and justified and to recover a higher proportion of the inflationary increases that impact our operations. We have made every attempt to do this in a reasonable and responsible manner, trying always to phase-in any increases gradually and always preferring negotiation to litigation.

We have also been able to enter into long-term transportation contracts with many of our utility customers in the same manner as coal producers have always been able to do. We now have about one-third of our volume under such contracts, many of which involve rate reductions in return for long-term volume commitments which help to protect the sizable investments we must make in order to handle coal traffic effectively and efficiently. Many other contract proposals are being negotiated with existing or potential new customers.

In these respects the Staggers Act has helped us to bring our coal traffic closer to acceptable levels of profitability. But, we are also making every effort to increase the productivity of our already highly-efficient unit train operations and of the operation of our system generally. We take much pride in providing our customers with a service "product" of the highest order, and given the chance to achieve and maintain the economic viability we believe was envisioned in the Staggers Act, we hope to be able to continue to provide top-notch coal transportation service to the coal users and producers.

In summary, I believe it is important for the Congress and the public to keep in mind that the current misfortunes of the coal industry are basically market problems -- not transportation problems. Producers and railroads alike have been disappointed by the failed expectations of coal demand here and abroad.

We intend to continue working with the producers and users we are privileged to serve to extend markets wherever possible and to provide the most efficient service-conscious system of transportation possible.

Senator WARNER. Before Mr. Marshall speaks, I am going to do something that is perhaps a little unusual. This is such a complicated issue, and in fairness to the coal panel, Mr. Ford, I think we should invite them back following the rail panel for any rebuttals since they let off. You had the opportunity to hear their testimony, and now I think in fairness to them, those that wish to volunteer to come up and reconstitute that coal panel may do so for purposes of rebuttal.

I want to make a fair case, and then we will hear the ICC and wrap up at 12:30. We will hear the ICC before the rebuttal.

Mr. Marshall.

STATEMENT OF CHARLES N. MARSHALL, VICE PRESIDENT, MARKETING, CONSOLIDATED RAIL CORPORATION, PHILADELPHIA, PA

Mr. MARSHALL. Good morning, Senator Warner, Senator Ford.

My job at Conrail is to try to come up with prices that are attractive to our customers, the shippers of coal, the users of coal, and which are also attractive to us, and I am truly alarmed by what I hear this morning because there are people who have been talking in this room who would tie our hands, who would make it impossible for us to compete, and we are only beginning to be able to compete because of the tools that have been given us by the Staggers Act.

Conrail is the smaller kid on the block. Coal amounts to about a sixth——

Senator WARNER. Your personal pronoun we, is that the industry or Conrail?

Mr. MARSHALL. Conrail, just one rail; that is one of the things about the Staggers Act. We no longer means the industry because we do compete with each other. There are no more rate bureaus. There are no more rates set in unison, and that is the way that we, Conrail, expect to increase our market share. There is a lot of coal out there, and we want to get more of it. I think we can.

The difficulty with regulation is that it tends to homogenize the rate. It creates relationships. When a railroad makes a reduction in one place a shipper somewhere else says well, I should have the same rate, and inevitably the rate levels go down, or worst, rate reduction to the first shipper isn't made in the first place, and that is what we have seen in the past.

Out of fear, the railroads haven't reduced their rates because they have been afraid they would be locked in. Now we have been able to begin to do something about it under the Staggers Act. I think that we are going to see the old patterns changing. Here this morning we have heard various shippers talk about the loss of markets that they see because coal exporters overseas have been able to increase their production and eat into our markets, but the forces which we have seen at work are forces which are those of history.

The Staggers Act has only just begun to work. The rate patterns were there and grew up under regulation, and I haven't heard anyone say that reregulation would solve the export coal problem that grew up in the past couple of years. There is a chance, however, that deregulation can solve them.

Let me point to some of the things which have been going on, and which I think are going to increase in the years ahead.

First of all, there is export coal. Now most people don't think of Conrail as being a big force in export coal from West Virginia, and Kentucky, and Virginia, and the States that you are concerned with. That is true, but we do have a line that reaches down into the Kinola Valley, and there is some good coal there. We have to haul it the long way around to get it to Philadelphia, but we can do that, and because of deregulation, we took $2.50 out of our export rates last summer, and we have guaranteed those rates to our shippers through the end of 1984.

Now this is going to do two things. We think it is going to stimulate West Virginia shippers to look at Conrail and to use our rates which are now $2 to $3 a ton lower than we believe our competitors' rates are, and move their coal to Philadelphia. We think this is going to open up some healthy ferment in the industry. It is going to cause users of coal to look for different sources of coal. It is going to cause railroads to start to change, breaking up the old homogenized rate structure of that group under regulation.

The other thing that is going to happen is that the West Virginia coal can now be blended with Pennsylvania coal. It has a relatively high sulfur content. We take the clean West Virginia coal and mix it with the dirty Pennsylvania coal, and we get a product that will benefit everyone. The users can burn it because its quality will be ample for them. Pennsylvania coal miners will go back to work and mine more coal and the West Virginia producers will produce more coal. That is the kind of thing that deregulation can do, but we wouldn't have put in that rate had we thought that coal was going to continue to be regulated. It is very low. We can't afford to guarantee it forever. We have done it through the end of 1984, but it isn't a rate that is good for all times and all circumstances. It is only deregulation that gives us the opportunity to take that chance.

Now a few minutes ago Arnold McKinnon of Norfolk Southern talked about a rate on coal moving from West Virginia through the State of Virginia and then into barges or boats going to New England. Now that is an example of how competttion is beginning to grow up under the Staggers Act. Conrail learned about that movement and we made a dent. We cut our rate for New England Electric Co. which was the consumer. For a while we thought we had the coal locked up. They liked our low rates, and there were several indications—this is the press which I have attached to my statement—suggesting that we were going to buy Pennsylvania coal.

What happened? We lost. I'm sorry we did, but Norfolk Southern got it back. We don't know what their rate is, but the indications in articles reported in Coal Week are that they cut their rate to compete with us. That is a case of Pennsylvania coal, West Virginia coal competing with each other. It is a case where the Staggers Act worked. The shipper is happy, and the only reason I am not happy is that I didn't get the business.

Similarly contracts—when the Staggers Act was passed there were a lot of complaints brought. Those complaints challenged the existing rate structure that grew up under regulation. Now everyone is viewing with alarm what deregulation may bring, yet the litigation we have seen has been challenging regulation. We have been able to settle two-thirds of those coal complaints involving Conrail and were able to settle them with contracts that have been tailored to meet shippers' needs in a way that we could not have done prior to the Staggers Act and prior to deregulation.

The contracts range in term from 1 to 14 years. They involve private cars and railroad-owned cars. They involve Conrail mines and they involve mines on connecting railroads. The terms of the contracts are tailored to the needs of the individual market—something that we can do only as long as we can differentiate rates, only as long as we can compete, only as long as we are treated like other industries like the coal mines which are our customers.

The one point that I want to emphasize most today is that there is a single coal market involving sellers and buyers and railroads that transport the coal. If those three interests can't get together to make a deal, there is no deal, and when coal can come from South Africa, and Poland, and Australia, we all suffer if we can't get together and make a deal.

I think we can, and we are only just beginning to see the effects of deregulation. We haven't yet learned what benefits it can bring. I think those benefits can be substantial, and I think the rate reductions that we have seen at Conrail and I think we are beginning to see at other railroads are examples of the way in which the Staggers Act will benefit everyone, and reasons why it should be retained.

[The prepared statement of Mr. Marshall follows:]

Testimony of

Charles N. Marshall

Vice President-Marketing

Consolidated Rail Corporation

Before the

Subcommittee on Energy and Mineral Resources

United States Senate

RAILROAD COAL TRANSPORTATION POLICY

November 15, 1983

In 1983 Conrail will handle 65 million tons of coal which will produce $525 million in revenue. The coal business is important to the railroads of the United States, and it is very important to Conrail.

Competition in the coal business is pervasive. Competition is the dominant factor in determining railroad prices for coal movement. This competition is widespread in both domestic and export markets.

Coal buyers overseas have a nearly infinite array of choices. They may purchase coal or oil or other alternative fuels. They may buy coal anywhere in the world, including America, Canada, Poland, Australia, and South Africa. They may buy American coal that is handled by Eastern railroads to the North Atlantic ports, by barges to the Gulf Coast, or by Western railroads to the Pacific ports.

Likewise within the United States, competition is pervasive. Every day, electric utilities make choices as to where to buy their coal, where to locate new generating stations, whether to ship by rail or barge or truck, and whether to substitute high voltage electric transmission for coal transportation. Non-utility coal customers, such as steel mills, face a similar array of choices as between different origin mines. And competition among coal consumers further constrains the market for any particular movement of coal.

It is true that coals have different characteristics such as sulphur content, ash production, BTU value, and cost of mining. Despite those differences, however, different coals can be broadly competitive. Automobiles also come in large numbers of colors and styles, but dissimilar automobiles still are regarded by purchasers as interchangeable for many purposes. Most consumers of coal have a broad range of sources from which to obtain coal that meets the specifications required. In extreme cases, we have seen a utility seek competitive bids on low-BTU Western coal and high-BTU Eastern coal. We have seen other utilities compare the use of high-cost, low-sulphur coal without expensive scrubbers with the use of low-cost, high-sulphur coal with expensive scrubbers. And, of course, many utilities switch back and forth from oil to coal depending upon market circumstances. So competition is the pervasive and dominant characteristic of the coal transportation market.

Only because of the Staggers Act has Conrail been able to meet this competition on terms most advantageous to our customers. The reason is that we are now able to differentiate the transportation terms for particular movements according to the particular needs of the market involved. Under regulation, there was a tendency to homogenize rates. This artificial uniformity led to market distortions and the exclusion of many coal shippers from markets they can now serve. Under regulation, shippers who felt that their rates were relatively high would claim discrimination, and the overall rate level would be forced down. As a result of this fear of rate reductions, carriers would maintain their rates at uniformly high levels. American coal markets, both domestic and export, suffered. The contracts which the Staggers Act has made possible, the lifting of the ban against "preference and prejudice" (the statutory clause often used to compel non-economic rate equalization) by the Staggers Act, and the deregulation of export coal have all encouraged more flexible transportation pricing arrangements. This flexibility has stimulated competition in a way that never before was possible.

Let me give some examples of the kind of healthy, competitive, differential coal rail pricing we are now seeing.

Export Coal Reductions:

In a series of rate reductions in December 1981, October 1982, and August 1983, Conrail slashed its export coal rates to compete with other railroads. The reduction in August of this year made export rates uniform from all Conrail origins in Pennsylvania and West Virginia, despite greatly different haul distances. The new $13.40 export rate is $2.50 below the former rate prevailing from West Virginia origins. The reduced rates give West Virginia low-sulphur coal shippers the opportunity to reach Conrail's Pier 124 at Philadelphia at lower rates than prevail over Chessie System and N&W to the piers of those railroads at Newport News and Norfolk. Conrail's Pennsylvania exporters should find the new low West Virginia rates helpful in attracting low-sulphur West Virginia coal to Philadelphia for blending with high-sulphur Pennsylvania coal, thus making the Pennsylvania coal more marketable. We have guaranteed the new, uniform $13.40 rate through the end of 1984 in order to give exporters a reasonable time to make the commercial commitments that are necessary to use the new rate.

Utility Coal Contracts:

Conrail has aggressively pursued coal contracts with the utilities that we serve in order to develop new movements on Conrail and provide the rate stability which the utilities desire. Contracts have resulted in dismissal of nearly two-thirds of the Staggers Act rate complaint cases involving coal movements where Conrail was the lead defendent (14 of the 22 cases have thus been settled, and we expect more to be settled this way in the future). The terms of these contracts vary widely. For example, the contracts range in length from one year to fourteen years. The escalation of rates provided for varies, as do the equipment commitments. Without the rate flexibility provided by the contract provisions of the Staggers Act, Conrail would not be able to tailor its price and service arrangements to the needs of these individual markets. A senior officer of one utility which is served only by Conrail recently stated publicly that "this long term contract gives us favorable rates and insures reliable delivery of the coal we need."

Frozen Coal:

During a sudden freeze two years ago, a significant amount of coal froze solid in rail cars before those cars could be unloaded into vessel for export. Under regulation, Conrail would have been obliged to charge demurrage on these cars or go through protracted regulatory proceedings seeking to waive the charges. Under the flexibility provided by the Staggers Act, we were able to sign a contract with the shipper allowing the shipper to store the cars full of frozen coal (cars were then surplus, so the storage cost the railroad little) until the spring thaw. The shipper then could substitute other cars of coal which were moved from mine to ship quickly to prevent freezing. Shipper and carrier alike avoided the expense of attempting to thaw the frozen cars, protracted litigation, and significant inconvenience which would have been caused had the old regulatory regime prevailed.

Rail-Water Utility Coal for New England:

New England Electric receives coal in a rail-ship movement from mines on the N&W. The coal had traditionally been unloaded at Norfolk and moved in coastal service to the receiving utility. The pricing freedom and competition spurred by the Staggers Act led Conrail and New England Electric to negotiate for a new source of this coal on Conrail. The attached newspaper articles show that very real price competition between Conrail and N&W resulted. Although N&W ultimately retained the business, indications are that the shipper obtained more favorable terms than would have been possible without the competition induced by the Staggers Act.

The Staggers Act has been a constructive and helpful tool in inducing the railroads and the consumers of coal to work together to further the markets of both. When coal can be mined in Poland or South Africa for $15 a ton less than the United States, rail rates cannot be blamed for the failure of American mines to capture the international market. But with the help of the Staggers Act and the flexibility it provides, coal sellers, coal buyers, and railroads can cooperate in viewing coal production, transportation, and consumption as a single market to be developed for the benefit of all three parties. The litigation, name-calling, and finger-pointing which have gone on in recent years have obscured the commerical reality of healthy competition that will strengthen Americal domestic and export coal markets for the future.

But the strengthening of those markets can occur only as long as the pricing flexibility permitted by the Staggers Act continues. Individual coal rates must not be made public, for if the old rules requiring equalized rates are reinstated, then rail freight coal pricing will return to a homogenous and non-competitive rate structure. American coal markets cannot afford to turn back the clock.

Roanoke Times and World News-Dec. 18, 1982

Conrail cuts rates, tries to gain coal traffic

By JAMES A. BACON
Staff writer

Trying to break into a coal export market dominated by CSX Corp. and Norfolk Southern Corp., Conrail has cut freight rates for coal shipped through its port in Philadelphia.

The coal industry has praised the Philadelphia-based Consolidated Rail Corp. for spurring competition, but executives with the two Virginia railroads say they doubt the lower rates will divert much business from their coal ports in Norfolk or Newport News.

Rail executives describe Conrail's aggressive strategy as a sign of hard economic times. Conrail needs to boost coal exports after spending $40 million to modernize its coal port, says Tom Hoppin, director of financial communications for CSX.

Conrail's port project was conceived during the export boom of 1980-81 when the coal ports at Hampton Roads and Baltimore couldn't handle an unexpected surge in coal exports. Conrail expanded its loading capacity from about 3.5 million tons to 10 million tons a year, but exports have slumped so dramatically in recent months that most railroads are hard pressed to hold on to the business they have.

Thanks in large part to rate increases of roughly 50 percent since 1979, hauling coal has been immensely profitable for most railway companies. Although price increases have moderated in 1982, and many railroads are granting rate reductions in exchange for long-term contracts, Conrail is the first to cut coal hauling rates in head-to-head competition with another railroad.

"Conrail's been looking good in the last couple of years," says Joseph Lema, vice president-transportation for the National Coal Association. The railroad has aggressively pursued new coal traffic and has shown a willingness to cut rates to get it. "I don't know anybody else who's done that."

"We've had to be aggressive. Our backs were against the wall," says Saul Resnick, a Conrail spokesman. Created by Congress in 1976 from the merger of six bankrupt railroads in the Northeast, Conrail faced dismemberment if it couldn't wean itself from government subsidies and start making a profit.

Although Conrail ranks as one of the nation's top 10 coal-hauling railroads thanks to its access to the Pennsylvania coalfields, the export potential of its coal has been limited by its high sulfur content. To attract overseas buyers, Pennsylvania coal must be mixed with lower-sulfur coal from central Appalachia, which traditionally has been shipped to the Chesapeake Bay ports.

Conrail designed its rates specifically to capture low-sulfur coal shipped by CSX to Baltimore and Newport News. Conrail's rates are 4 to 13 percent below CSX's, even though Philadelphia is much farther from the West Virginia coalfields.

Marianne Slough, Conrail's manager of export coal, is confident the experiment will pay off. Conrail is willing to accept a lower profit margin than the other railroads in order to get a foot in the coal export door, she says.

Although CSX and NS executives are keeping close tabs on Conrail's price-cutting gambit, they say they aren't particularly concerned.

Conrail may offer slightly lower rates, but CSX can provide quicker runs from mine to port, and its piers can handle larger vessels, says Tom Hoppin, director of financial communications for CSX, which competes most directly with Conrail. "As far as we know, we haven't lost any business."

Ms. Slough concedes that lower rates haven't brought in much new business yet, but she says the real test will come in early 1983 when the Philadelphia pier completes installation of new equipment capable of loading larger vessels.

Conrail's initiative has stirred considerable interest in Europe, says William B. Bales, Norfolk Southern's vice president of coal and ore traffic, who has just returned from a trip overseas. But he thinks the stratagem has received more attention than it deserves.

He doesn't anticipate any impact on the Norfolk Southern's export of metallurgical coal through Norfolk, Bales says. It's too early to say if the Norfolk Southern needs to adjust its own rates in response, however. He says he hasn't had a chance to take up the matter with the board. "We're studying the matter."

The Washington Times JAN 10 1983

Coal order canceled; W. Virginia stunned

By Marc Lerner
SPECIAL TO THE WASHINGTON TIMES

The West Virginia coal industry has been dealt a dispiriting blow — the cancellation of a 400,000-ton order from New England's largest electric generating plant.

New England Electric System says high coal-hauling rates on the Norfolk-Western Railway prematurely killed after two years an agreement that was set to run through 1997, according to utility spokeswoman Susan Shittaker.

The move is expected to throw 250 Wyoming County, W. Va., coal miners out of work and is considered a personal setback for West Virginia Gov. John Rockefeller, who had ballyhooed the deal as an indicator of the state coal industry's bright future.

The agreement between New England Electric and Big Bear Mining Co., a subsidiary of A.T. Massey Coal Co. of Richmond, Va., supplied coal to the utility's Brayton Point plant in Somerset, Mass.

The power company claims West Virginia coal moving by rail would cost $3 million more this year than similar Pennsylvania coal.

The unexpected winner in the hassle is U.S. Steel Corp., which will use some of its reserves — available because of slack demand for coal in the depressed steel industry — to fill the order.

New England Electric insists it was pleased with the quality and price of Massey coal, as well as service provided by the railroad. "It was the high rates on Norfolk Western that forced us out," Whittaker says.

In September 1982, the most recent month for which statistics are available, Big Bear shipped 18,500 tons of coal to the utility at a delivered price of $67.52 a ton. Rail rates to Norfolk, Va., accounted for $15.97 a ton of that cost. The coal moves from Norfolk to New England by barge.

New England Electric claims it can save $5 to $7 a ton by moving Pennsylvania coal on Conrail to Philadelphia and by barge from there.

But William Bales, vice president for coal and ore traffic at the railroad's parent company, Norfolk Southern Corp., says that the rail rate is a smokescreen the utility is using to cancel the contract. The utility vehemently denies the charge.

Bales blames the lost business on the utility's rigid bargaining position, claiming New England Electric demanded rail rates recommended by a utility consultant — rates that Bales says are unprofitable.

The episode has left a cloud of acrimony following months of negotiation by the utility, the railroad, the coal company and West Virginia's governor.

James Joyce, president of Wyomac Coal Co., a Massey division that manages Big Bear, first learned of the cancellation in local news reports — a slip New England Electric now regrets. Joyce expects to send a final shipment of 25,000 to 30,000 tons of coal to Brayton Point before gearing down operations.

Dan Green, director of the state's Coal Development Authority, says the failed deal adds fuel to the argument that coal slurry pipelines are needed. The proposed lines would carry a mixture of crushed coal and water and would compete with railroads for coal-hauling business.

MANASSAS, VA.
JOURNAL MESSENGER
DEC 30 1982

Cancellation of Coal Contract May Mean More Rail Competition

By JAMES A. BACON
Roanoke Times & World News

ROANOKE, Va. (AP) — New England Electric System, contending that Norfolk & Western Railway's rate for hauling coal is more than 30 percent higher than its competition, is looking to Conrail.

New England Electric has terminated a contract with A.T. Massey Coal Co. of Richmond and is negotiating with Conrail and an unnamed Pennsylvania coal producer.

The canceled contract has set off a political furor in West Virginia that may spill over into Mirginia. Ad-

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vocates of coal slurry pipelines in both states say the incident shows the railroad industry needs more competition for hauling coal.

Massey was supplying 400,000 tons of coal a year to New England's Brayton Point plant in Massachusetts.

"Massey had been an excellent supplier and we hated not to renew the contract," but N&W's rates made the economics too unfavorable, said Damon Lawrence, manager of coal supply for the Massachusetts-based electric power company.

"We're disappointed, but we should have known better," said E. Morgan Massey, president of A.T. Massey. N&W was using monopoly power to prop up the price of its lucrative coal export rates, he said. If N&W had reduced its rates for Massey and New England Electric, Massey said, the railroad would have faced strong pressure to revise its entire rate structure.

Under the contract, A.T. Massey mined coal at its Big Bear operation in Wyoming County, W.Va., and had enough reserves for at least 15 years. But the contract included provisions for the annual renegotiation of prices and allowed either New England Electric or Massey to bail out if an agreement couldn't be reached.

When it came time to renew the contract this month, New England decided it could strike a better deal with Conrail, which serves the northern Appalachian coalfields and operates a coal pier in Philadelphia.

In the current dismal coal market, the cancellation of the contract means A.T. Massey will have to close its mine, Massey said. That will mean the loss of 250 more jobs, dealing another blow to West Virginia's battered coalfield economy.

New England Electric is now close to an agreement with Conrail on the key provisions of a contract, Lawrence said.

N&W was charging about $16 a ton to haul Massey's coal from West Virginia to Norfolk, and it looks like Conrail will charge $12 a ton or less, Lawrence said.

William B. Bales, vice president of coal and ore traffic for Norfolk Southern Corp., N&W's parent company, said it is unfair to single out the N&W as the villain in the rate dispute. In truth, he said, N&W has offered significantly lower rail rates to New England Electric, but the utility has been unwilling to discuss them.

West Virginia authorities had regarded the Massey contract as an important toehold for West Virginia producers in the fast-growing market for coal in New England. Gov. Jay Rockefeller took a personal interest in the progress of the negotiations between N&W and New England Electric, said Tom Reishman, manager of research for the West Virginia Coal Development Authority.

When New England Electric announced its intention to cancel the contract, Rockefeller dusted off an old proposal to build a coal slurry pipeline from West Virginia to a port in Virginia or Maryland.

Supporters of coal slurry legislation in Virginia also cite the incident as evidence of the need for slurry pipelines to provide effective competition with the railroads. The railroads "can charge whatever they want to charge," says Curry Roberts, executive director of the Virginians for Competitive Coal Transportation, a Richmond lobbying group.

At roughly $12 a ton, Conrail will pick up $4.8 million a year if the contract goes through. "It's a case where everybody loses: the N&W, the coal company and the state," Reishman said.

It is unreasonable to blame all the problems of the West Virginia coal industry on N&W, Bales said, citing the example of a major producer in Virginia that continues to supply coal to New England Electric. The company is served by the N&W, he said.

Although profitable, the lost 400,000 tons represents an insignificant fraction of the 114 million tons of coal hauled by Norfolk Southern rail lines in the last 12 months. But a reduction of rates by only $1 per ton would mean a rate cut of 6 to 7 percent.

It is unreasonable to blame all the problems of the West Virginia coal industry on the N&W, Bales said, citing the example of a major producer in Virginia that continues to supply coal to New England Electric. The company is served by the N&W, he said.

N&W is under "tremendous pressure from all the foreign buyers" to cut their prices, Massey said. A concession to A.T. Massey and New England Electric would have set a precedent, and other shippers would demand similar reductions. The consequences could be devastating for the NW's coal hauling revenues, he said. "We would have been naive to expect the NW to make concessions on freight rates..."

Bales acknowledged that N&W is under considerable foreign pressure to reduce its rates, but he said a rate cut to New England would not inevitably lead to rate cuts to coal destined for the export market. N&W wants to break into the New England coal market and is willing to make some concessions that it wouldn't consider with well-established traffic like the export market.

New England Electric is not the only power company dissatisfied with the high cost of railroad transportation. In recent months, West Virginia state officials have visted about 20 power companies. Most complained that high rail rates were making central Appalachian coal less competitive, said Reishman with the coal development authority.

"So many utilities have told us they are not satisfied that it leads us to believe there is a pretty significant problem," Reishman said.

If the electric utilities have major complaints, Bales said he hasn't heard them. He said the railroad is conducting daily discussions with some of the major electric utilities in the Southeast.

Senator WARNER. Thank you very much. Any further questions, Mr. Ford?

Senator FORD. No.

Senator WARNER. Thank you gentlemen. We will now hear from the ICC—Mr. Reese Taylor, Chairman; Mr. Frederic Andre, Commissioner; Mr. Malcolm Sterrett, Vice Chairman; and Ms. Heather Gradison, Commissioner.

Chairman TAYLOR. Good morning, Mr. Chairman.

Senator WARNER. In accordance with the practice adopted by the Chair for all witnesses, your statements in their entirety will be placed in the record and you are urged to summarize. An example of that procedure was followed by the last witness.

Chairman TAYLOR. I will endeavor to provide a summary. Let me begin by introducing the people at the table with me this morning; although you may know my colleagues, I would like to introduce them for the record—Vice Chairman Malcolm Sterrett, Commissioner Frederic Andre, and Commissioner Heather Gradison.

Several staff members are present. On my immediate left is Ron Young, Director of the Commission's Bureau of Accounts, and on my far right is Robert Maestro from our Environmental Section, who is familiar with the environmental assessment in the export coal case, in the event some questions come up with respect to that. On my immediate right is the Commission's legislative counsel, Janice Rosenak.

STATEMENT OF HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION, WASHINGTON, DC, ACCOMPANIED BY RON YOUNG, DIRECTOR, BUREAU OF ACCOUNTS, ROBERT MAESTRO, ENVIRONMENTAL SECTION, AND JANICE ROSENAK, LEGISLATIVE COUNSEL

Chairman TAYLOR. I want to thank you, Mr. Chairman, for the opportunity to appear here today and present the views of the Commission concerning recent regulatory actions related to railroad coal transportation.

I have submitted a written statement for the record and would like to summarize that statement briefly for you at this time. Since your letter requesting the Commission's testimony specifically referred to the export coal decision, we will discuss that proceeding in detail.

First, however, it may be helpful if I provide some background concerning the Staggers Rail Act and our implementation of that legislation.

As you know, the Staggers Rail Act of 1980 profoundly changed rail regulation. Under the Staggers Act, a rail carrier may establish a rate at any level it desires, absent discrimination, so long as it contributes to going concern value.

The act also establishes revenue variable cost ratios below which the Commission has no jurisdiction over the reasonableness of rates. If rates exceed the applicable jurisdictional threshold, now at 175 percent, and the carrier has market dominance, the Commission is authorized to determine whether the rate is reasonable. Thus, accurate market dominance determinations are central to fulfilling the goals of the Staggers Act, namely, that competition and demand for services are to be the determining factors in railroad ratemaking except where there is an absence of effective competition.

In ex parte No. 320—Sub-No. 2—the Commission adopted new guidelines which reflect the provisions of the Staggers Act and our experience to date with the market dominance rules established pursuant to the 4R Act.

Our decision in this proceeding eliminates the prior rebuttable presumptions of market dominance based on cost, market share, and substantial investment. Presumptions have been replaced with general guidelines. Because of the wide variation in circumstances from case to case, we believe the flexible approach we have adopted will provide a more useful and reliable method for determining a railroad's market power in a given situation.

Included in our market dominance determination is consideration of product and geographic competition. Upon appeal, the fifth circuit held that the Commission is prohibited from considering evidence of product or geographic competition in making a determination of market dominance. However, a rehearing was granted. The case was originally argued on June 7, 1983. The decision by the court is expected some time soon.

The Staggers Act also required that we complete a proceeding to adopt standards and procedures for use in establishing adequate revenue levels for rail carriers, and then, on the basis of those procedures, to determine which carriers are revenue adequate on an annual basis.

The initial standards adopted utilized minimum and short-term standards of revenue adequacy. These measures of revenue adequacy were subsequently modified in favor of a single standard, a rate of return equal to the current cost of capital. This single standard was established in view of the Staggers Act emphasis on the importance of long-term revenue adequacy as a regulatory consideration.

The Commission's decision has been affirmed by the courts. It is important to distinguish between cash flow and revenue adequacy. I think that is a very important point. Cash flow is a measure of the current shortrun financial position of a business, while revenue adequacy is a condition of long-term viability. The mandate of the Commission is to provide the railroads with the opportunity to earn sufficient revenues to ensure their long-term viability.

The Commission recently proposed further refinements to the existing revenue adequacy standard as part of a continuing effort to enhance that standard by adopting revisions to improve its accuracy. Comments have been filed in this proceeding and are presently being analyzed.

Another important recent decision is ex parte 347—Sub-No. 1. We have heard a lot about it this morning—Coal Rate Guidelines, Nationwide. In that proceeding, the Commission proposed a maximum rail rate policy applicable to captive coal traffic.

Under the proposed constrained market-pricing approach, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the stand-alone cost of serving the traffic.

Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of honest, economic, and efficient management.

Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year after inflation. Might I say, that was intended to be a maximum and not a minimum.

Fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the three other constraints. If the rate on market-dominant coal traffic violates any one of the constraints, it could be found unreasonable.

Each factor acts as an independent restraint, but all were intended and designed to work together as a matrix. That is also important in our view. I should point out, however, that two of my colleagues dissented in this decision, and they are here so I am sure they can explain this dissent.

This proposal represents the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a systemwide basis all variable costs and constant costs, including a return on investments equal to the current cost of capital.

The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option.

Accordingly, to reach revenue adequacy, railroads have to price some movements differentially, in other words, allocate constant costs disproportionately. Comments in this proceeding were filed in late July and are presently being carefully reviewed by the Commission. We haven't issued a decision yet; it is still a pending matter.

Turning now to export coal, by decision served June 9, 1983, the Commission exempted rail export coal from regulation. This exemption became effective on September 12, 1983, after petitions for stay were denied by the Commission and the U.S. Court of Appeals for the District of Columbia.

In view of the controversial nature of the decision, which as you point out was not unanimous, I will not summarize the differing viewpoints at this time. Instead, when appropriate, I will summarize my position, because I think you all know I dissented and feel rather strongly about it. The majority position will be orally presented by those Commissioners who are here this morning. A copy of the decision and the decision on the petitions for stay have been attached to the record.

That concludes my prepared statement, Mr. Chairman, and I would presume at this time you would perhaps like to hear from my colleagues with regard to their views on export coal or any other matters that I have discussed.

[The prepared statement of Chairman Taylor follows:]

STATEMENT OF THE INTERSTATE COMMERCE COMMISSION BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES OF THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES ON THE COAL RAILROAD TRANSPORTATION SYSTEM

November 15, 1983

Mr. Chairman and Members of the Subcommittee:

We want to thank you for this opportunity to present the views of the Commission on recent regulatory actions related to railroad coal transportation.

Your letter requesting the Commission's testimony specifically referred to our decision to exempt from regulation the transportation of export coal. That proceeding will therefore be discussed at the outset.

The Commission's decision in Ex Parte No. 346 (Sub-No. 7), Railroad Exemption-Export Coal, was reached only after compilation and careful consideration of a massive evidentiary record, and after oral argument held before the entire Commission. The decision rests in law upon a determination made under 49 U.S.C. 10505 that regulation under the Interstate Commerce Act is not necessary to carry out the rail transportation policy contained in 49 U.S.C. 10101a, or to protect shippers from the abuse of market power.

The reasoning underlying the legal conclusion is contained in the formal legal opinions issued June 9 and August 31, 1981 (copies attached). On September 9, 1983, the Court of Appeals for the District of Columbia Circuit denied motions for stay pending judicial review, and on September 22, 1983, motion for rehearing en banc was also denied. The exemption thus took effect as scheduled on September 12, 1983.

Given the complexity of the legal and economic issues presented in this proceeding, an understanding of the case can best be attained through reference to the attached full opinions. We will, however, offer a summary of the reasoning underlying the decision.

The Export Coal evidentiary record demonstrates that export coal transactions are conducted in a naturally competitive market environment. Several other countries compete with the United States in the world market, most notably Poland, West Germany, South Africa, Canada, and Australia. These countries, in most instances, are more proximate to the foreign users and, as a consequence, bear lower overall transportation costs. Foreign competition, therefore, imposes a heavy restraint on the market allowable price for American coal.

American producers and carriers have a common interest in the profitable marketing of as much coal as the world market will absorb. It is primarily because of this commonality of interest that the Commission believes the market acts as an adequate constraint on export coal rates. Both rail carriers and producers have invested heavily in equipment and facilities used for the production and movement of export coal. The Commission believes there is every reason to expect that both producers and carriers will price their products and services reasonably and rationally so as to remain competitive in world markets and to assure an adequate return on their heavy capital investments. It should be borne in mind that loss of export coal traffic would bring as great a hardship to the carriers as it would to the producers.

The evidentiary record also shows relatively equal bargaining power between the producers and carriers. Most export movements are arranged by large transshippers with substantial bargaining power. For example, the record shows that the eight largest transshippers account for 66 percent of the coal exports handled by the Chessie and 83 percent handled by the N&W. These transshippers strengthen through brokerage activities what may appear to be the weak bargaining power of the small producers, and the larger producers have independent strength through access to their many sources of supply. The large producers dominate the export coal business. Six companies account for 68.5 percent of all of N&W's single-line export coal business, while the same number account for 57.0 percent and 54.8 percent for the B&O and C&O, respectively. Four companies (Pittston, Consol, A.T. Massey, and Island Creek) are among the top six shippers on both N&W and B&O, and two of these are among the top six shippers on the C&O. The transshippers and large producers have recourse to many sources of coal supply and transportation alternatives, both intermodal and intramodal.

Two other important factors warrant mention as constraints on railroad pricing. First, the exemption carries with it the removal of antitrust immunity, subjecting export coal transportation to the same legal strictures applicable elsewhere in the economy. Secondly, the Commission may revoke the exemption in whole or in part at any time if its expectations prove inaccurate and abuses materialize.

In assessing the worth of regulation of this traffic, the Commission made every effort in its decision to determine what regulation has accomplished in the past. There is little evidence that regulation has had any material beneficial impact on export coal rates. In the 6 years preceding passage of the Staggers Rail Act of 1980, not a single maximum rate complaint concerning export coal was filed with the Commission, and the rates did not even keep pace with average rail cost increases. Between 1975 and 1981, export coal rates for the eastern carriers increased 82 percent while their overall costs rose 93 percent. Furthermore, the carriers in recent years have frequently "flagged out" (or not taken) Commission authorized general rate increases on export coal. During the 1969-1981 period, minehead prices of coal (in constant dollars) increased by approximately 250 percent, while export rail rates increased only 50 percent. All things considered, the record indicates that regulation of the rail transportation of export coal has achieved very little, and the absence of that regulation is likely to have little negative effect on export coal marketing. On the contrary, the Commission believes that this exemption from unnecessary regulation will have a beneficial effect in allowing the parties greater flexibility in marketing.

The Commission also believes the Export Coal decision is in keeping with the legislative history of the Staggers Act. Under 49 U.S.C. 10505, "the Commission is charged with the responsibility of actively persuing exemptions for transportation and service that comply with the section's standards." [H.R. Rept. No. 96-1035, 96th Cong., 2d Sess. 60 (1980)]. The Commission is further charged to exempt rail transportation in "as many [instances] as possible" and "adopt a policy of reviewing carrier actions after the fact to correct abuses of market power." (id. at 105). To that end, the Commission is closely monitoring the effects of this exemption in order to detect at an early stage any abuses or market disruptions that might occur. The exemption has been in effect for only two months but we have not yet seen any problems. The Commission wishes to assure the Congress, and particularly this Subcommittee, that should problems arise, the Commission stands ready to reassess its decision.

As you know, the Staggers Rail Act of 1980 profoundly changed rail regulation. The Staggers Act represented the second major effort in five years to resolve the continuing problem of railroad revenue adequacy. The first was the Railroad Revitalization and Regulatory Reform Act of 1976 ("4R Act"), which introduced the concepts of revenue adequacy and market dominance, and made them the basic principles of railroad regulation. Among other things, the Staggers Act made further refinements to these concepts.

One of the main reasons for enactment of both the Staggers Act and the 4R Act was the weakened financial condition of the railroad industry. The Acts were intended to assist the Nation's railroads to remain viable in the private sector and to allow them to compete more effectively among themselves and with other modes of transportation.

Section 205 of the 4R Act[1/] requires the Commission to make a continuing effort to assist the railroads in obtaining adequate revenues. The overall objective is to enable the railroads to "attract and retain capital in amounts adequate to provide a sound transportation system in the United States." Thus, with the 4R Act, a carrier's revenue adequacy assumed a central role in rail ratemaking.

The Staggers Act required that we complete a proceeding to adopt standards and procedures for use in establishing adequate revenue levels for rail carriers and then, on the

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1/ 49 U.S.C. 10704(a)(2).

basis of those procedures, determine which carriers are revenue adequate on an annual basis.

In Ex Parte 393[2] we concluded that railroads should have the opportunity to achieve earnings sufficient to yield a return on investment equal to the current cost of capital. As we explained in that case, railroads can obtain funds for investment only by offering rates of return comparable to other investment opportunities. Investments earning less than the cost of capital will not be able to retain existing funding or obtain new funding, because investors could invest available funds elsewhere at a higher rate of return. The Commission's decision in Ex Parte 393 was affirmed by the United States Court of Appeals, and the Supreme Court declined to review that decision.[3]

In order for the railroads to reach revenue adequacy, they must be free to adjust their rates in a timely fashion, free from regulation in markets where there is competition. Thus, the 4R Act established "market dominance"--the absence of effective competition--as the threshold test for Commission rate regulation. The Staggers Act quantified this market dominance standard. Now a rail carrier may establish a rate at any level it desires (absent discrimination) so long as it contributes to going concern value. The Act also establishes revenue/variable cost ratios below which the Commission has no jurisdiction over the reasonableness of rates.[4/] If a rate exceeds the applicable jurisdictional threshold and the carrier has market dominance, the Commission is authorized to determine whether the rate is reasonable.

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[2] Standards for Determining Railroad Revenue Adequacy, 364 I.C.C. 803 (1981), aff'd sub nom., Bessemer & Lake Erie R.R. v. I.C.C., 691 F.2d 1104 (3d. Cir. 1982), cert. denied, 51 U.S.L.W. 3872 (U.S. June 7, 1982) (No. 82-1369).

[3] See id.

Thus, accurate market dominance determinations are central to fulfilling the goals of the Staggers Act, namely, that the market place is to be the determining factor in railroad ratemaking except where there is an absence of effective competition.

In Ex Parte No. 320 (Sub-No. 2),[5/] the Commission adopted new guidelines which reflect the provisions of the Staggers Act and our experience to date with the market dominance rules established pursuant to the 4R Act. Basically, this proceeding had two purposes: (1) a reexamination of existing market dominance regulations; and (2) a determination, as mandated by section 205 of the Staggers Act, as to whether and to what extent "product competition" should be considered in determining the reasonableness of rates.

[4/] These ratios commence at 160 percent in 1980, subsequently rising in 5-percent increments until October 1, 1984, at which time the cost recovery percentage becomes applicable, subject to a floor of 170 percent and a ceiling of 180 percent. Under the statute, the cost recovery percentage would have become applicable on October 1, 1983, if it were less than 175 percent. Since that was not the case, the present jurisdiccional threshold is 175 percent.

[5/] Market Dominance Determinations and Considerations of Product Competition, 365 I.C.C. 118 (1981).

The Commission's decision in this proceeding eliminates the prior rebuttable presumptions of market dominance based on cost, market share, and substantial investment. The presumptions have been replaced with general guidelines. Because of the wide variation in circumstances from case to case, we believe the flexible approach adopted will provide a more useful and reliable method for determining the railroad's market power in a given situation.

The Commission concluded that product and geographic competition should not be considered in reasonableness determinations, since such assessments are based primarily on a comparison of the challenged rate and the cost of the movement to which it applies. However, these two factors (which are traditional factors assessed when determining competition in antitrust litigation) are evidence of the existence of competition that can serve as effective constraints on the abuse of market power by rail carriers. Therefore, product and geographic competition are relevant in determining whether a carrier is market dominant vis-a-vis particular traffic.[6]

Last year, the United States Court of Appeals for the Fifth Circuit, in a 2-1 decision, reversed part of the Commission's decision in Ex Parte 320 (Sub-No. 2).[7] However, a rehearing en banc was granted, vacating the court's earlier decision, and the case was reargued on June 7, 1983. A decision by the court is expected in the next several months. In the meantime, the Commission's market dominance regulations remain in effect.

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[6] Under the Commission's prior regulations, product and market competition were not considered germane in computing market share, but such evidence could be introduced to show that effective competition existed.

[7] Western Coal Traffic League v. United States, 694 F.2d 378 (5th Cir. 1982), reh'g en banc granted, No. 81-4257 (March 7, 1983).

The market dominance threshold has freed from rate regulation much of the traffic that moves by rail. However, railroad rates for coal transportation are often subject to Commission scrutiny. While a substantial amount of coal transported by rail now moves under contract, there are still cases where the reasonableness of coal rates is in dispute. In Ex Parte 347 (Sub-No. 1), Coal Rate Guidelines--Nationwide (served February 24, 1983), the Commission proposed a maximum rail rate policy applicable to captive coal traffic.[8] Under the proposed "constrained market pricing" approach, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the "stand-alone cost" of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of "honest, economical and efficient management." Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year (after inflation). Fourth, until a rail carrier achieves revenue adequacy, it would be free to

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8/ Vice Chairman Sterrett and Commissioner Andre dissented.

adjust its rates on captive coal traffic, unless it violates one of the three other constraints. If the rate on market dominant coal traffic violates any one of the constraints, it could be found unreasonable -- each factor acts as an independent restraint.

This proposal represents the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a system-wide basis all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option. Accordingly, to reach revenue adequacy, railroads have to price some movements differentially (in other words, allocate constant costs disproportionately). Comments in this proceeding were filed in late July and are presently being reviewed by the Commission.

In conclusion, as we recently testified at Staggers oversight hearings, the Commission is attempting to promote more efficient operations, by eliminating burdensome regulations and practices which tended to stifle innovative rail management. Innovative ratemaking and marketing have been encouraged and supported. Our various rulemaking proceedings are intended to improve competition and provide better rail service to the shipping community.

That concludes my prepared statement, and now, Mr. Chairman, I will be pleased to respond to any quetions you may have.

Chairman Taylor dissented in the Export Coal case. His views will be presented at the hearing and are set forth in the decisions appended to the statement.

SUMMARY OF CHAIRMAN TAYLOR'S VIEWS ON EXPORT COAL

As you know, I dissented from the Export Coal decision. Despite evidence of record that 95% of the mines producing export coal are captive to just one railroad, the majority is apparently convinced that the nature of the world market, combined with the bargaining power of the larger transshippers, will provide the necessary constraints against market abuse.

I emphatically disagree with this conclusion, and I regard the exemption as a serious mistake. It is contrary to the intent of Congress, and it is unsupported by the evidence of record in the proceeding. In fact, as I pointed out in my dissent, the decision consisted primarily of a summarization of the proponent railroads' comments. The Export Coal decision, to use the language of the U.S. Court of Appeals for the District of Columbia in a recent decision, "bear(s) the earmarks of a hasty rout, not the measured passage from the old regime to the new for which Congress provided."[1]

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[1] Ford Motor Co. v. I.C.C., Nos. 82-1630 and 8321743, slip op. at 3 (D.C. Cir. August 9, 1983).

WITH REGARD TO CONGRESSIONAL INTENT, THE LEGISLATIVE HISTORY OF THE STAGGERS ACT REFLECTS PARTICULAR CONCERN OVER CAPTIVE COAL TRAFFIC -- COAL WAS THE ONLY COMMODITY SINGLED OUT FOR DISCUSSION IN VARIOUS INSTANCES. AND I WOULD EMPHASIZE THAT CONGRESS DID NOT DISTINGUISH BETWEEN DOMESTIC AND EXPORT COAL. TO THE CONTRARY, FLOOR STATEMENTS EXPRESSED THE NEED FOR MAINTENANCE OF REASONABLE RATES ON DOMESTIC AND EXPORT COAL.

AS FAR AS I AM CONCERNED, ANY REASONABLE ANLAYSIS MUST CONSIDER THE EFFECTS OF THE EXEMPTION ON BOTH RATES AND SERVICE. RELIANCE ON THE WORLD MARKET, AND ON THE LEVERAGE OF A FEW LARGE SHIPPERS (LEVERAGE WHICH IS QUESTIONABLE AT BEST, BASED ON THE EVIDENCE OF RECORD), CAN ONLY ENSURE THAT ANY COAL MOVING FOR EXPORT WILL DO SO AT OR BELOW THE MAXIMUM WORLD PRICE. IT WILL NOT, HOWEVER, ENSURE REASONABLE RATES, NOR A REASONABLE DIVISION OF PROFITS BETWEEN THE RAILROADS AND THE MINE OPERATORS. NOR WILL IT ENABLE THE CAPTIVE SHIPPER TO MOVE ITS COAL IF A RAILROAD, FREED FROM ITS COMMON CARRIER OBLIGATION, DETERMINES NOT TO SERVE THE SHIPPER OR TO CONDITION SERVICE UPON UNREASONABLE RATES.

It should be emphasized that, while petitioners sought a limited rate exemption, the Commission, nonetheless, granted a total exemption from all provisions of subtitle IV of Title 49 U.S.C. -- despite the fact, I might add, that the record contained not a scintilla of evidence concerning the need for, or impact of, an exemption from the common carrier obligation, the commodities clause, or the prohibition against discrimination.[2]

There is also cause for concern about the broader ramifications of the exemption. Our own environmental asssessment[3] projected a substantial decline or reduced growth in production for several coal supply regions, including Virginia, and a complete loss of all export production in others. Moreover, in addition to the economic and social effects of these losses, the exemption is in direct conflict with the Administration's efforts to stimulate foreign demand for U.S. coal.

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[2] In view of the fact that petitioners amended their request to seek an exemption from only the rate provisions of 49 U.S.C. 10701-10712, the parties did not address the merits of an exemption from the non-rate provisions of the statute.

[3] As explained in detail in my dissent, in the majority's unexplained rush to issue this decision, the required environmental impact statement and energy impact statement have both been omitted.

CONSIDER, IF YOU WILL, THE MANIFEST CONTRADICTION THAT NOW EXISTS BETWEEN THE COMMISSION'S REMOVAL OF ALL PRICING CONSTRAINTS ON RAIL MOVEMENTS OF EXPORT COAL, ON THE ONE HAND, AND ON THE OTHER, THE ADMINISTRATION'S EARNEST ATTEMPT TO RECAPTURE OUR FORMER ONE-THIRD SHARE OF THE JAPANESE COAL MARKET.

RIGHT NOW, DUE TO THE HIGH DELIVERED PRICE OF U.S. COAL, OUR SHARE OF THE JAPANESE MARKET IS ONLY 16 PERCENT, AND IT IS ESTIMATED THAT REGAINING OUR LOST MARKET SHARE WOULD CUT $1.5 BILLION FROM A PROJECTED $22 BILLION TRADE DEFICIT WITH JAPAN, WHILE PROVIDING JOBS FOR 55,000 AMERICANS.

FINALLY, THE POTENTIAL REVOCATION OF THIS EXEMPTION, AFTER THE ABUSES HAVE OCCURRED, IS ABOUT AS VIABLE AN ALTERNATIVE AS CLOSING THE BARN DOOR AFTER THE HORSES HAVE ESCAPED. FOREIGN MARKETS, ONCE LOST, CANNOT BE EASILY REGAINED. ONE DOES NOT MOVE EASILY IN AND OUT OF THE EXPORT COAL MARKET. THE COMMISSION'S ABILITY TO REVOKE THE EXEMPTION PROVIDES ONLY AFTER-THE-FACT ASSURANCES. IN ORDER TO JUSTIFY A REVOCATION, THE HARM WOULD HAVE TO OCCUR, NOTICE WOULD HAVE TO BE GIVEN, COMMENTS WOULD HAVE TO BE

RECEIVED, AND POSITIVE ACTION WOULD HAVE TO BE TAKEN BY THE COMMISSION. BY THE TIME THIS CHAIN OF EVENTS TAKES PLACE, THE DAMAGE WILL HAVE BEEN DONE, SO REVOCATION IS, AT BEST, AN IMAGINED REMEDY.

TO SUMMARIZE, THE EXPORT COAL EXEMPTION, BY SHIFTING PROFIT FROM PRODUCER TO CARRIER, MAY WELL PRECIPITATE A LONG-TERM DECLINE IN COAL EXPORTS, UNDERCUT A KEY ELEMENT OF U.S. INTERNATIONAL ENERGY POLICY, IMPAIR THE HEALTH OF THE COAL MINING INDUSTRY, JEOPARDIZE THE JOBS OF THOUSANDS, AND SUBSTANTIALLY WEAKEN, IF NOT ELIMINATE, A POTENTIALLY IMPORTANT FACTOR IN OUR NATION'S STRUGGLE TO REGAIN A FAVORABLE BALANCE OF TRADE.

FOR THE RECORD, I HAVE ATTACHED TO THIS STATEMENT HIGHLIGHTS OF MY DISSENT IN THE *COAL EXPORT* PROCEEDING.

HIGHLIGHTS OF CHAIRMAN TAYLOR'S DISSENT

- The legislative history of the Staggers Rail Act shows Congressional concern for captive coal traffic. Coal was the only commodity to be singled out several times in the Committee's reports. No distinction was made between export and domestic coal.

- The central issues are: without I.C.C. regulation, would the competition in world and domestic markets both (1) hold coal rates to reasonable levels; and (2) encourage and expand the transportation of export coal. The answer is no--the necessary competition is not present.

- The evidence indicates that the exemption will result in increased rates and decreased demand.

- Competition in the world export market has only limited relevance here. At best, it will only provide a price cap - a maximum price above which coal will not move for export. However, the price cap will not ensure a reasonable division of profit between railroads and coal producers, nor guarantee the movement at all.

- Export coal shippers are clearly captive. There is no intermodal or intramodal competition, nor product or geographic competition. Ninety-five percent of the individual mines producing export coal are served by only one railroad. Railroads are able to charge high rates without fear of diverting traffic.

- Subject to a price cap, the railroads have an incentive to maximize profits, not to share them with coal producers. This reduces the incentive for mine operators to expand their production. Therefore, a railroad can effectively determine a mine's return on investment.

- Existing contract provisions are adequate to protect all parties without a need for this exemption. Also, the railroads have significant rate flexibility now.

- The railroads admitted that they will use discriminatory pricing (as opposed to differential pricing) under the exemption, by basing rates on the mines' costs, not their own. This will dissuade mine operators from expansion and/or productivity increases.

The evidence suggests that the exemption will result in a decline in coal exports, contrary to the national energy goals and contrary to the Administration's goals of increasing coal exports to our allies. The Commission's own Environmental Assessment Statement shows that by 1985, Virginia, Utah and Colorado will experience a complete loss of all export production directly as a result of the declining demand for export coal brought about by increased transportation rates. These losses will have a severe, adverse impact on the employment levels, upon local and regional tax bases and upon the communities and families dependent on those mines which are forced to decrease or stop production.

The antitrust laws will not protect shippers from market abuse. They provide no protection against actions by one railroad.

The exemption decision lacks an environmental impact statement or energy impact statement. Ironically, the entire Commission issued a notice of EIS in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, finding a significant environmental effect arises out of any major change in coal rate regulation.

The potential revocation of this exemption if abuses do occur is not acceptable, because serious damage can occur in a short period of time.

SERVICE DATE
JUN 9 1983

EC

INTERSTATE COMMERCE COMMISSION

Ex Parte No. 346 (Sub-No. 7)

RAILROAD EXEMPTION-EXPORT COAL

Decided: May 26, 1983.

Petition for exemption of export coal is granted. Regulation is not necessary to carry out the rail transportation policy or to protect shippers from the abuse of market power.

DECISION

BY THE COMMISSION:

On September 4, 1981, we published a notice in the Federal Register (46 Fed. Reg. 44529) seeking comment on a proposal to exempt,pursuant to 49 U.S.C. 10505, export coal from some or all of our regulation. After considering the comments and hearing oral argument, we have decided to exempt export coal rail traffic moving from United States ports, including Great Lakes ports, from all provisions of 49 U.S.C. Subtitle IV. We will allow interested persons 30 days to comment on the question of whether the exemption should be extended to the transportation of export coal moving in all-rail service to Canada and Mexico.

We will first discuss the world market for export coal, the United States export coal transportation system, and the positions of the parties. We will then apply the statutory exemption criteria to the facts and discuss energy and environmental considerations.

I. BACKGROUND

On March 30, 1981, the Norfolk and Western Railway Company (now a subsidiary of Norfolk Southern Corporation) (N&W) petitioned us to exempt from regulation export coal traffic moving by rail through Atlantic and Gulf ports. Its petition was supported by the Chessie System Railroads (Chessie) and the Family Lines Rail System. In our September 4th notice, we expanded the scope of the request and sought comment on the merits of exempting all export coal traffic from some or all of our regulation. In response to the initial comments, petitioners narrowed the scope of the exemption request to the rate regulation provisions of the Interstate Commerce Act. 49 U.S.C. 10701-10712.[1] After analyzing the opening and reply statements, we sought further information, principally on the nature of the world coal market and whether coals from different countries are substitutable in filling buyers' steam or metallurgical coal requirements. That information was received on June 4, 1982. We heard oral argument on June 16, 1982.

All of the railroads appearing (including the Western Railroads[2]) and the United States Department of Transportation (DOT) favor the exemption. Mine owners, the National Industrial Transportation League, various other shippers, the Water Transport Association, the Commission's Office of Special

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[1] Since we are granting the broader exemption initially proposed, we need not further consider this more limited exemption proposal.

[2] The Union Pacific Railroad Company; the Atchison, Topeka and Santa Fe Railway Company; Burlington Northern Railroad Company; Southern Pacific Transportation Co.; Utah Railway Co.; Western Pacific Railroad Co.; The Denver & Rio Grande Western Railroad Co.

Counsel, the United States Departments of Commerce (Commerce) and State (State) and the United States Trade Representative oppose it. The Department of Justice (Justice) has expressed no opinion except that if an exemption is granted, the Commission should make it clear, that, as a matter of law and policy, there can be no antitrust immunity for this transportation.

II. THE WORLD MARKET

A. Structure

Coal exported from the United States is a part of a competitive world coal market made up of large and sophisticated buyers and sellers. As explained below, this competition effectively restrains the rates charged by the rail carriers for transportation from mine to port, and the delivered price of the coal in foreign ports.

1. The Sellers

Several participants in this proceeding make much of the fact that many coal mines are served by a single rail carrier. We do not attach as much significance to this fact because we are concerned with rates for coal shipments. Most shipments of export coal are arranged not by a mine or an overseas buyer, but by a broker known as a transshipper. The transshipper assembles an order of coal and arranges shipping as required by the overseas buyer's schedule. A transshipper may also function as both producer and broker, and may supply coal from mines it owns as well as from mines of other companies. In this way it can collectivize the shipments of smaller producers. If there is a supply contract with a foreign user, it is almost invariably with the transshipper, and not with a specific mine.3/ Further, it is the transshipper who negotiates transportation rates with the rail carrier.

The majority of all U.S. coal exports are arranged by a small number of these companies. The eight largest transshippers account for 66 percent of coal exports on the Chessie and 83 percent on the N&W.4/ These exporters obtain coal from mines located on both of these two large and competing coal hauling roads as well as from Conrail and other carriers. Thus, while many mines are located on only one railroad line, the railroads must negotiate their rates with companies that can obtain coal from mines located on the lines of several carriers. This fact significantly undercuts the assumption that mines producing export coal are captive to individual railroads, or that the transshippers are without competitive alternatives.

We also think it important that the coal shipping companies are often owned by larger conglomerates such as AMOCO, Dupont, International Telephone and Telegraph, and Shell Oil Company, and that these companies may in some instances be able to exert leverage over particular railroad rates as a result of other domestic or export coal shipments or other rail traffic they tender. Further, many of these companies are developing international coal reserves which could be used to meet foreign demands for coal.5/

3/ Supp. N&W and Chessie, p. 17-13, supp. v. s. Ecklund p. 3.

4/ See reply v.s. Chessie-N&W, Barber, at 39-44 and reply, Thompson at 5-9.

5/ Reply v.s. Chessie-N&W, Barber, p. 16-17.

Finally, we note that United States coal shippers face intense competition from major coal suppliers around the world. These competitors are large, well organized, and sometimes government-supported firms in Australia, South Africa, Canada, Poland, and West Germany. The record shows that suppliers in these countries have been quite effective in expanding their world market shares in recent years, as discussed in more detail below.

2. The Buyers

Most export coal is purchased by large users in industrialized nations. The two principal groups of consuming nations are in Western Europe and in the Far East or Pacific Rim. Because coal is a low-value bulk commodity, transportation costs account for a large portion of the delivered price of coal. Accordingly, coal is usually most economically imported from the nearest source, unless quality constraints and reliability of supply dictate otherwise.

Each supplier's market share of a particular market tends to be inversely related to distance from the particular market. For example, Australia and Canada export relatively little coal to Western Europe, but supply two-thirds of the coal imported by Pacific Rim countries (virtually all of Canada's coal is in the West and exports go through Pacific ports). Conversely, Poland and South Africa, which sell most of their coal to customers relatively close at hand in Western Europe and together supply more than half that area's import market, are only secondary suppliers to the Far East.

Nevertheless, a few sales are always made to more distant markets, such as Australia to Western Europe or South Africa to Japan,because of quality differences, demand, security of supply, or old customer ties. The desire of importers for a variety of sources also operates to blur market lines. For example, South Africa, which shipped no coal to Japan until very recently, now accounts for 5 percent of the Japanese market.[6]

3. Types of Coal

Coal of various grades and qualities is found in most of the major coal exporting countries, so that, at any given time, coals of all types and grades compete for sale in Europe and the Far East. There are certain requirements for particular uses because coal must possess the proper ash, moisture, sulfur, and carbon content, have the requisite volatility, and supply the necessary thermal units to be effective at a given site.

There are two main uses for coal. Metallurgical coal is used in the production of steel, and must be of a very high quality. Steam coal, used primarily in the generation of electricity, need not meet quite so demanding a standard. Though specifications are more rigid for metallurgical than for steam coal, all coal must perform to strict requirements if it is to be useful in a particular operation, and thus coal purchases are boiler or process specific.

Although the shippers have contended that innovation in the way steel is produced will not have a profound effect on the market, it is clear that technological improvements in the production of coke and the manufacture of steel, as well as greater experience in blending coals of disparate characteristics to achieve a desired quality of coke, have lessened the restrictions on metallurgical coal and permitted the use of lower grade coal.[7] This has allowed more suppliers into the market and greatly heightened worldwide competition for metallurgical coal sales.

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[6] Supp. N&W-Chessie, v. S. Ecklund, p. 15.

Negotiation for the purchase of coal begins with laboratory test data (designating the mineral specifications) and the trial of relatively small sample quantities of coal. When a producer has established both the suitability of its coal for the buyer's particular use and its reliability, the chief remaining terms to be negotiated are quantity, price, and penalty premium provisions to assure delivered quality. Thus, the selection of potential suppliers is made on the basis of quality and security of supply. Usually this process identifies several qualified suppliers and the final decision is almost invariably made on the basis of competitive price.[8]

4. Coal Availability

To some extent, each of the countries competing with the United States has been hampered in its efforts to expand production. Both Australia and Poland have labor problems; South Africa has export quotas. Colombia and China have vast coal reserves but enormous expenditures are necessary to develop the export potential. Nevertheless, the current development of these exporting countries and their plans for further expansion (See Appendix E) leave little doubt that world coal supply will increase to meet any future increases in demand.

Both Poland and South Africa, each with substantial coal reserves, are among the most aggressive exporters in the world market today. Poland seeks to recapture lost markets after its recent strike, and South Africa seeks to compensate for the falling price of gold. Both have recently reduced the price of their coal and have plans to expand production considerably. South Africa has recently increased its export quota and has financed a large expansion of its Richard's Bay port capacity. Australia and Canada also plan to increase both their production of coal and their port capacity, while heavy investments are being made to develop exports from Colombia and China.

B. Pricing

All of the principal parties in this proceeding agree that coal tends to move on a net delivered price basis. That is, within fairly close constraints, as a supplier's net delivered price increases, its market share decreases. Correlatively, as the net delivered price of coal close at hand increases, more coal moves longer distances across market lines.

Further, the international coal market is extremely sensitive to changes in the delivered price. The price sensitivity of overseas purchasers has been attested to by numerous parties. One particular illustration is the reaction of the Japanese to the rapid increase in the mine-mouth price of American metallurgical coal during 1974. Japanese users responded by: (a) purchasing more coal from Australia, (b) placing price ceilings on the escalation clauses in new contracts, and (c) developing technological innovations which reduced the need for metallurgical coal. Because of its high price, the United States' share of the Japanese coal market has been steadily declining, while the market share of Canada and South Africa has gradually increased. In 1980 the United States had about 32 percent of the

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[7] Supp. N&W--Chessie, v.s. Ecklund, pp. 8-11.

[8] Comm. N&W--Chessie, v.s. Ecklund, pp. 9-13.

Japanese met coal market, down from 53 percent in 1970.[9] This experience shows quite vividly that foreign users will change suppliers if the delivered price of one supplier is relatively higher than others.

Coal production has now been expanded throughout the world beyond the reasonable ability of the current market to absorb it,[10] and this surplus is aggravated by the current decline in the world price of oil. These trends ensure that there will most likely continue to be vigorous price competition in the world export coal market at least for the near future.

C. The Position of the U.S. in the Market

Until quite recently, world coal trade centered around the ocean shipment of met coal, and the demand for that coal was affected by cyclical patterns of the steel industry. Though several countries exported this coal, the United States was the chief supplier because of its high quality Appalachian coal. This pattern altered radically in 1979 with the huge oil price increase, and within a short time steam coal used to generate electricity began being exported around the globe in very large quantities. Steam coal is available from a number of countries, some closer than the United States to the major markets. Since most of those sources also supply an acceptable quality of metallurgical coal, often at a lower delivered price, the United States rapidly lost its position as the world's principal coal exporter. Although the United States is geographically positioned to supply both Western Europe and the Far East, foreign suppliers are often able to deliver their product to consuming regions at a price significantly below the price of coal from American origins. As Appendix E illustrates, the U.S. delivered price for steam coal from Western origins to Japan in 1980 was some 40 percent higher than the price for Australian coal.[11] Similarly, the delivered price for steam coal from Appalachian origins to Europe in 1980 was some 21 percent higher than the price for South African coal.[12] Canada offered a price to Japan equivalent to what the United States would offer but Poland's price to Europe (not shown in Appendix E) would be much lower than ours.

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[9] v.s. of Minoru Tada or behalf of Nippon Steel Corp., Table 1.

[10] See for example reply N&W--Chessie, v.s. Ecklund, p. 4, and opposition letter of Nippon Steel Corporation.

[11] Reply N&W--Chessie, v.s. Barber, p. 13. It has been difficult to develop precise estimates as the parties do not cite the same figures. Frequently they aggregate countries differently and cite figures for different years or cite to themselves rather than to independent sources. Where there is sharp disagreement among the parties, a wide range, or a complete absence of data, we have referred to ICF Incorporated, Potential Role of Appalachian Producers in the Steam Coal Export Market: Task #1, International Steam Coal Trade Analysis, prepared for the Appalachian Regional Commission, November, 1981, cited by NERA, and referred to below as the Appalachian Study. That study shows the U.S. having 29 percent of global steam coal exports in 1980. See Appendix C, p. 1.

[12] Supp. N&W-Chessie, v.s. Ecklund, p. 5; Supp. v.s., NERA; Tables 2 and 3. (The year in Table 3 is given as "1981" but this apparently is a typographical error - both the text and the source refer to 1980). The Appalachian Study shows 45 percent.

As of 1980, the United States accounted for just over 20 percent of identified global steam coal exports, which is less than the 32 percent shipped from South Africa, less than the 30 percent shipped from Poland, and only slightly higher than the amount exported by both Australia and Canada combined.[13] America also had between 38 and 45 percent[14] of the world metallurgical coal market. Even when metallurgical coal is included with U.S. export movements of steam coal, the competition to our exports is clearly evident; the combined share of total identified exports attributable to Australia and Canada (33 percent) and the combined share from Poland and South Africa (32 percent) were about equal to that of the United States (roughly 35 percent).[15] Overseas buyers are willing to pay a premium of about 10 percent[16] for American coal because this country has the advantage of political and economic stability and an abundant supply of coal. But because this premium is already reflected in the price of American coal, if any producer raises the price it shifts the equilibrium in favor of its competitiors.

As the Departments of State and Commerce, the International Trade Representative, and several overseas purchasers, including Nippon Steel Corporation and Anker Kolen of Rotterdam, all testify, unless American coal is competitively priced, purchasers will turn to other suppliers who will meet their specifications. This testimony is supported by the conclusion of the Inter-Agency Coal Export Task Force that the role of the United States in future coal trade "depends upon the buying strategies of the consuming nations, the policies and prices of competing exporters, and the actions taken by the United States to maintain reasonable prices, prompt delivery and dependable quality."[17]

III. U.S. TRANSPORTATION SYSTEM FOR COAL EXPORT

A. Structure

Rigorous international competition for export coal sales is not the only source of pricing discipline faced by U.S. railroads. The market power of individual railroads is also constrained by intramodal, intermodal, and geographic competition within the U.S. export coal market. Thus, even if the U.S. share of the world coal market would remain relatively stable, a U.S. railroad could not increase its rates on export coal without risking loss of traffic to coal mines located on the lines of other railroads or on waterways.

"Eastern" coal is mined in the Appalachian coal fields of Kentucky, Tennessee, Pennsylvania, Virginia, and West Virginia; "midwestern" coal includes the relatively high sulfur coal fields of Ohio, Indiana, and Illinois. These coals move primarily over the lines of Norfolk & Western Railway Co. (to Lamberts Point) and over the two Chessie System carriers, Baltimore & Ohio Railroad Co. (to Baltimore), and the Chesapeake & Ohio Railway Co. (to Newport News). Indeed, as recently as 1979, these three carriers accounted for nearly 90 percent of total non-Canadian U.S. coal exports, although this share dropped to 65 percent with the boom in export coal movements in 1980 and 1981:

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[13] Reply Chessie-N&W, v.s. Barber, at 13.

[14] Id.

[15] Id.

[16] Reply Chessie-N&W, v.s. Ecklund, p. 5, NERA, p. 54.

[17] U.S. Department of Energy, Interim Report of the Interagency Coal Export Task Force, January, 1981 (DOE1-0012), at 4 (emphasis supplied).

Figure 1

VOLUME AND SHARE OF NON-CANADIAN U.S.
EXPORTS ACCOUNTED FOR BY B&O, C&O, AND N&W, 1979-1981
(Millions of tons and percent)[18]

	Total Non-Canadian Exports		B&O		C&O		N&W	
	Tons	Percent	Tons	Percent	Tons	Percent	Tons	Percent
1979	45.6	100.0	9.1	20.0	8.8	19.3	23.0	50.4
1980	72.8	100.0	12.4	17.0	18.0	24.7	30.5	41.9
1981	92.4	100.0	12.7	13.7	15.7	17.0	31.9	34.5

Conrail also serves a number of Appalachian coal origins; although current export movements are limited, coal handling improvements on Conrail's lines and in Philadelphia will increase Conrail's coal export capability.

Export coal originated on the lines of an eastern rail carrier is generally transported in single line service to that carrier's own export coal facility.[19] Nevertheless, although very few mines are located on the lines of more than one railroad, coal producers are not without bargaining power in dealing with their railroad. First, as noted above, rail rates for export coal movements are frequently negotiated not by the mine owner, but by a transshipper who is *not* limited to obtaining coal from the mines on only one railroad. Second, a substantial percentage of U.S. coal mines are controlled by large mining companies owning numerous mines on the lines of different railroads. These companies can credibly threaten to fill their orders from mines on other railroads or on waterways if a particular rail carrier does not offer reasonable rates.[20] Third, there is a substantial volume of coal--approximately 13 percent of total production[21]--which is currently moved by truck, and in many cases coal can easily be trucked to the tipple of another railroad for domestic or export movement. The ability of trucks to successfully compete for short-haul movements of coal has an effect on competition for long-haul movements of coal. It creates the real potential for intermodal truck-barge or truck-rail movement to compete with an all-rail movement. Finally, some mines have direct access to waterways and others are located close enough to a waterway to permit feasible truck/barge intermodal operations. For example, during the first nine months of 1981, 17 percent of reported tidewater and coastal port shipments (nearly all of which is for export) was handled by inland water carriers.[22]

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[18] Source: Reply N&W-Chessie, v.s. Barber, facing pg. 33.

[19] Joint or combination rates are published from (for example) CSX origins to NWS' facility at Lamberts Point, but these rates are substantially above the single--line rates from the same origins to CSX' facilities at Newport News or Baltimore. Intermodal barge service is also available, but again the rail portion of the intermodal rate is substantially above the corresponding single-line rate (on a $/ton or $/ton-mile basis). Supp. N&W-Chessie, 29-31.

[20] Six companies account for 68.5 percent of all of N&W's single-line export coal business, while the same number account for 57.0 percent and 54.8 percent for B&O and C&O, respectively. Four companies (Pittston, Consol, A.T. Massey, and Island Creek) are among the top six shippers on both N&W and B&O; two of these are also among the top six shippers on C&O. Reply N&W-Chessie, v.s. Thompson, at 8. These companies shipped from many different origins; on the C&O, for example, 164 different origins accounted for 64 percent of its export coal traffic. *Id.*, v.s. Gobrecht, p. 14.

[21] The Department of Energy's 1981 publication, United States Coal at a Glance, 1980, shows that 13 percent of coal produced in the United States was transported by truck. See also N&W--Chessie, v.s. Gould, Landes & Stillman, pp. 21-22 and Exhibit 1.

Coal from Colorado and Utah is moving in small though increasing amounts through West Coast ports over either the Union Pacific Railroad or the Denver & Rio Grande Western Railroad (in joint line service with Southern Pacific Transportation). For example, Union Pacific handled 600 unit trains of export coal in 1981--almost four times the number it handled in 1980.[23]

Coal from the Powder River Basin in Wyoming, which is currently served only by the Burlington Northern Railroad, does not yet move for export (in part due to its relatively low BTU content), but the substantial tonnages present in the area make exports a distinct possibility. Neither barge nor truck coal movements are feasible for western coal. As in the East, individual mines are generally located on the lines of only one railroad. Although generally western coal for export now moves only to the Pacific Rim countries and the primary export market for eastern and midwestern coal is in Europe, competition among the regions appears to be growing. Department of Energy data show that the proportion of shipments of export coal from the West and Midwest went from virtually nil in 1979 to nearly 12 percent of all export coal traffic in the third quarter of 1981.[24] During this same period, N&W and Chessie (combined) experienced a 27 percent reduction in their percentage share of non-Canadian coal exports.[25] Although some of the increased tonnage out of New Orleans during this period is properly ascribed to capacity constraints at the Atlantic ports, these data also suggest that midwestern coal can compete successfully in some markets with eastern coal.

Coal suppliers in each region compete with other suppliers in their own and in other regions for a portion of the American "share" of the world export market. Rail carriers within each region similarly compete with other rail carriers, or with barge carriers, in their own or in other regions for a "share" of that market. Transshippers compete with other transshippers, and also seek to maintain or even expand the American "share" of the world coal market by arranging for delivery of suitable coal to foreign buyers at the lowest possible price covering mine-mouth price, rail rates, vessel charter fees, and their own costs. By increasing its own prices, any of the many participants in the movement of coal from mine to foreign buyer can make a particular bid non-competitive.

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[22] Reply N&W-Chessie, v.s. Barber, at 28 (Citing data compiled and provided by the Department of Energy). Mr. Barber further notes that from some coal producing districts, the barge share was as high as 90 percent.

[23] Statement of Thomas B. Graves, Jr. of Union Pacific R. Co., before the Senate Subcommittee on Energy and Minerals Resources (December 3, 1981), at 2. (cited by Barber, Reply of N&W-Chessie at 31).

[24] Reply N&W-Chessie, v.s. Barber, p. 19.

[25] Computation from Figure 1.

In short, a foreign buyer has more than a choice of countries from which to purchase coal. At least with respect to the American market, that buyer also has a choice of regions, of mines, and of railroads. Thus, all participants in the export coal business, whether involved in extraction, rail transportation, water transportation, or brokerage, operate in a competitive environment in which an increase in the aggregate rate for their services can cause a foreign coal buyer to accept a bid involving other mines and other carriers. The forces of competition thus weigh equally on the pricing action of railroads, mines, transshippers, and barge owners. Yet only one of these participants--the railroads--is currently subject to any regulation.

B. Pricing Behavior

The history of rail export coal pricing behavior supports the premise of the railroads that the railroads' export coal prices are constrained by strong delivered price competition and that railroads are dealing with customers who have substantial bargaining power. At the outset, we note that not a single maximum rate complaint concerning export coal was filed with the Commission before 1980. Moreover, the 1980 complaints appear to have been filed not because of any new railroad rate actions, but because Section 229(b) of the Staggers Act provided that rates not challenged by a certain date would forever thereafter be conclusively presumed lawful. We also note that Section 229 of the Staggers Act immediately produced over 800 maximum rail rate complaints. In sharp contrast to this history for export coal, analogous movements of domestic coal during the same period were subjected to substantial increases, and were the subject of extensive litigation before the Commission and the courts. Further, the railroads were successful in persuading the Commission to change its maximum rate standards. The railroads, however, did not at the same time seek to test the outer limits of rate regulation on export coal, but were content to raise their rates only in connection with general rate increases for all traffic. Indeed, the railroads "flagged out" of several general rate increases on export coal, presumably due to competitive factors. This is not the kind of behavior which we think characterizes entities exercising unrestrained market power.

The railroads have argued that if export coal rates are deregulated they will be able to negotiate the shares of the available economic rents between every link in the export chain: producers, rail carriers, and ocean carriers. In analyzing this proposition, which we believe goes to the heart of this case, it is useful to observe how these economic rents have been divided in the past when the delivered price of coal has risen sharply due to world oil shortages. Between 1969 and 1974 minehead prices (in current dollars) increased 468 percent, while export rail rates rose only 57 percent.[26] Coal prices (in real dollar terms) as of December 1981 were more than two and a half times greater than they were in 1969, but export rail rates increased by less than half.[27] These results indicate at a minimum that the unregulated shippers of export coal have considerable economic bargaining power in the contest over division of the economic rents from export coal. We recognize that the past is not a perfect indication of future conduct, but we think that it is significant that no complaints were filed and that rates could not even keep pace with measures of rail average costs. In fact, between 1975 and 1981, export coal rates for the eastern carriers increased 82 percent while their overall index of materials costs rose 93 percent.[28] One eastern carrier, Conrail, recently reduced its rate on export coal at Philadelphia by 58 cents per ton.[29] This history indicates that the pricing restraint of rail carriers was not the result of the exercise of regulatory power by this Commission, but rather resulted from the play of market forces.

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[26] Reply N&W-Chessie, v.s. Barber, p . 49.

[27] Id., pp. 49-50.

IV. POSITIONS OF THE PARTIES

A. Proponents' Arguments

1. Selective Pricing.

The railroads argue that they are economically rational, and will act according to their long-term economic self-interest if export traffic is exempted. This would lead them to price their services selectively rather than raise their rates uniformly.

The railroads point out that it is undeniably to their advantage to generate as much revenue as possible on profitable traffic, and they can earn large profits from hauling coal. They argue that if they can increase rates on some movements and retain the traffic, they have an incentive to do so. However, if a rate increase would eliminate a particular movement, then they plainly have a disincentive to increase the rate on that movement. By charging their more price-sensitive mines a lower rate and keeping them in the market, the railroads intend to increase their revenue above what they would realize by increasing prices uniformly, driving some mines out of the market, and reducing tonnage. They submit that a reduction in volume would not be in their interest so long as they can charge different rates to different shippers.

In the absence of regulation, the railroads and DOT expect that coal rates would be arrived at through negotiation. They point out that because the world market sets a price cap for export coal, each party has great incentive to reach agreement, since failure results in the loss of the opportunity to share the profit. If a mine decides not to produce, the railroad loses traffic because foreign purchasers will obtain that coal volume from an overseas supplier, or from mines located on the lines of other carriers. The coal producer, however, may have some alternatives if no agreement is reached. Where a company is served by more than one railroad, or where it has access to barge or truck, its bargaining power would be improved. If it can sell its coal on the domestic market, moving it via the regulated rates of the same carrier with which it is negotiating for an export rate, its bargaining position would be improved considerably. A shipper who could also draw upon coal from several mines on more than one railroad would be in a still better position.

The railroads explain that if (1) the world market will tolerate a port price of $50 a ton, (2) a mine owner could produce the coal for $20 a ton, and (3) the railroad could haul it to the port for $20 a ton, then the available profit to be shared between the producer and the railroad would be $10 a ton. If the railroad has numerous alternatives and the coal producer has none, the railroad would be likely to receive much of the $10 a ton profit. Similarly, if the coal producer is the party with the opportunities to mitigate the adverse consequences of failure to agree, then the coal producer would receive much of the profit. In many instances, both parties will probably have some alternatives, and the division of the profit should be somewhere between these limits. Under all possible divisions of the available profit, the competitive price of $50 a ton would prevail in the market place, and there would be no effect on the volume of coal purchased or produced. The carriers argue that even though the rail rate which results from negotiation may in some cases be higher than under regulation, it is better to allow railroads freely to negotiate the prices for their services to generate sufficient capital for the operation of safe and efficient transportation system.

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[28] Id., p. 50. See also Reply, N&W Chessie, v.s. Goorecht, pp. 10-11.

[29] Id., p. 32.

2. Relative Bargaining Power

The railroads have submitted[30] detailed information listing shippers, mine origins, port destinations, and tonnage shipped in 1981. They stress that many of the larger exporters are owned by energy conglomerates such as Shell, Conoco, and Amoco, and argue that the shippers are relatively few, very large, and highly concentrated. The railroads and DOT maintain that the exporters are not captive to any particular carrier, but rather are free to shift among mines served by different railroads and to seek out inland transportation on the most attractive terms. They argue that a single railroad, however, is vitally dependent on the mines on its lines and must respond to the competitive alternatives available to coal shippers. In bargaining with these shippers, railroad pricing inflexibility may result in a large loss of traffic and revenue.

3. Facilitating Contracts.

The railroads and DOT argue that if export coal were deregulated they would be in a stronger position to negotiate long-term export coal rate contracts. The railroads claim that currently shippers who would sign such contracts insist upon a clause which would bind them to rate and service commitments while allowing regulatory intervention seriously to erode projected revenue. The two largest coal exporters, Chessie and N&W, in their pleadings state that they have entered no long term contracts for the transportation of export coal despite the advantages they feel could be gained through contracting. We note that these railroads now have filed contracts for export coal movements.

B. Opponents' Arguments

The mine owners and the shippers, joined by Commerce and State and the Special Counsel's Office, maintain that the railroads possess market power over coal exporters and will abuse that power in the absence of regulation. They note that although world competition sets a maximum price for export coal, in the absence of regulation the railroads and the mines would be forced to compete for the same dollars. They contend that, within the range between the mine-mouth cost and the world price, pricing discretion is unconstrained by world market competition. The railroads, they argue, could reduce the mine-mouth price of coal by raising their rates, and move producers closer to their marginal costs of production, and appropriate most of the available economic rents.

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[30] Under cover of protective order.

Commerce and State note that over 95 percent of individual mines producing export coal are served by only one railroad, and that most traffic, especially in the East, is handled by a single railroad from mine to port. The coal companies believe that the railroads are thus in a position to extract substantial premiums without fear of diverting traffic to other carriers. They fear that if export coal were deregulated the railroads would choose to raise rates to the point where a given volume will maximize revenues, even though some coal producers are excluded from the market and overall production is reduced. They perceive substantial potential for railroad abuse of market power and predict severely reduced coal exports and an overall decline in the nation's prosperity.

The National Industrial Transportation League is concerned that deregulation might induce the railroads to place so much of their resources into export coal that they would be unable to fulfill their common carrier obligation to other shippers. It also fears that the railroads may so reduce the rates on export coal that domestic shippers will be forced to subsidize export traffic.

The water carriers argue that if the exemption were granted the railroads would be able to charge higher export rates to ports whose dumping facilities they do not own, thus frustrating the building of private coal piers and curtailing the expansion of export capacity. They argue that the railroads have already restricted their barge transshipment rates. If the exemption were granted, the railroads would be free effectively to foreclose a shipper's freedom of choice by imposing rate or service disadvantages on the rail-water alternative as to nullify the competition.

Commerce, State, and NERA[31] predict that deregulation would result in rates which would depress export coal volumes. They fear that this would reduce employment, adversely affect our balance of trade, and jeopardize United States security as well as our international energy policy, which favors the use of coal by our allies. Commerce and State see this outcome as inconsistent with both the President's Coal Export Policy Statement, which stresses expansion of our coal exports, and with the national rail transportation policy to ensure effective competition "to meet the needs of the public and national defense" [49 U.S.C. 10101a(4)].

Commerce and State also argue that importing nations would view the deregulation of export coal (while domestic coal remained regulated) as discrimination aimed at extracting higher prices from overseas customers. That perception, they say, would very likely lead foreign customers to shift their planned coal purchases to other producing nations offering greater anticipated stability in the pricing of transportation.

After carefully considering the comments we have decided to grant the export coal exemption.

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[31] National Economic Research Associates (NERA), on behalf of the coal exporters, has attempted to forecast the economic consequences of export coal deregulation. Based on an across the board 57-percent increase in rail rates it projects a loss of 450 million tons in coal exports, and a reduction in United States real income of $4.2 billion over the period 1983-1990. The technical aspects of NERA's study and the railroads' criticism of it are analyzed in Appendix A. As that analysis demonstrates, not only is NERA's study flawed in its premise, but its calculation of welfare loss is also inaccurate.

V. EXEMPTION MEETS THE STATUTORY CRITERIA OF SECTION 10505

Our action here is taken under 49 U.S.C. 10505, which gives us broad authority to eliminate unnecessary regulation. *American Trucking Association, Inc.* v. *ICC*, 656 F.2d 1115, 1118-21, 1127 (5th Cir. 1981). See *Simmons* v. *ICC*, 697 F.2d 326 (D.C. Cir. 1982); *McGinness* v. *ICC*, 662 F.2d 853, 855-57 (D.C. Cir. 1981). Section 10505 provides that the Commission "shall" grant an exemption whenever it finds that continued regulation is not necessary to carry out the rail transportation policy and either the transaction is of limited scope or continued regulation is not necessary to protect shippers from market power abuse. Thus, the ultimate issue is whether regulation over any "matter related to a rail carrier," 49 U.S.C. 10505(a), *must* be retained. If regulation is not necessary, our instructions from Congress are to end it.[32]

Section 207 of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. 94-210 (4-R Act) (later codified at 49 U.S.C. 10505 (1978 Supp.)) gave us the authority to exempt railroad transactions or services from regulation if we found that regulation was (1) not necessary to carry out the transportation policy (2) would be an unreasonable burden and (3) would serve little or no useful public purpose. Section 213 of the Staggers Rail Act of 1980 relaxed the criteria under which we are to consider proposed exemptions. Although an exemption still may be granted only when regulation is not necessary to carry out the rail transportation policy, Section 10505 no longer requires a demonstration that continued regulation would impose an unreasonable burden on a petitioner or on interstate or foreign commerce and that regulation would serve little or no useful public purpose.

It is clear that Congress expected us to increase significantly the number and type of exemptions. The legislative history reveals that Section 10505 was considered an "important cornerstone" of the Staggers Act and that, under it, "the Commission is charged with the responsibility of actively pursuing exemptions for transportation and service that comply with the section's standards."[33] The policy underlying Section

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[32] Shipper interests argue that an exemption for export coal traffic is improper because coal was the one commodity singled out for protection during the deliberations on the Staggers Act. See comments of Coal Exporters Assn, p. 25. They point to language from the Senate Committee Report directing the Commission to ensure that coal traffic bear only its fair share of costs and that "higher rated captive traffic is not unduly burdened" and stating that the exemption power not be used "at the expense of captive shippers who have no reasonable transportation alternatives." S. Rep. No. 96-470, 96th Cong. 1st Sess. (1979).

While we recognize that Congress was concerned about coal rates, we do not believe that concern was meant to remove the exemption power granted by the new statute. Section 10505, as enacted in the Staggers Act, explicitly authorizes us to exempt any "matter." See *McGinness* v. *ICC*, *supra*, 662 F.2d at 855-857; *American Trucking Ass'ns Inc*. v. *ICC*, *supra*, 656 F.2d at 1118-22. Moreover, export coal must be distinguished from domestic coal transportation. Export coal traffic is not the captive traffic for which Congress continued rate regulation. See 49 U.S.C. 10101a(6). Rather, as we discuss elsewhere in this report, this traffic is subject to vigorous and growing competition from the world market and other transportation modes and energy sources, and these forces will provide adequate restraints on rates.

[33] H.R. Rept. No. 96-1035, 96th Cong., 2d Sess. 60 (1980).

10505 is that Congress has been able to identify broad areas where reduced regulation is clearly warranted, but that "the Commission is more capable through the administrative process of examining specific regulatory provisions and practices not yet addressed by Congress to determine where they can be deregulated consistent with the policies of Congress."34/ The conferees expected that "as many as possible of the Commission's restrictions on changes in prices and services by rail carriers will be removed through the use of Section 10505, and that the Commission will adopt a policy of reviewing carrier action after the fact to correct abuses of market power."35/

In implementing Section 10505, we have granted general exemptions from regulation for the rail transportation of fresh fruits and vegetables, and various agricultural commodities, and food items, among others; an exemption for frozen foods has also been proposed. In addition, we exempted all transportation provided by railroads in"piggyback" equipment (trailers and containers on flat cars or TOFC/COFC)36/ and the transportation by boxcar of all commodities except non-ferrous recyclable materials. Those actions are consistent with our exemption here.

We grant the export coal exemption because continued regulation is not necessary either to carry out the rail transportation policy of Section 10101a or to protect shippers from the abuse of market power, as we now explain.37/

A. The Exemption is Consistent With The National Transportation Policy

Continued regulation of export coal traffic is not needed to carry out any of the fifteen elements of the rail transportation policy set out in 49 U.S.C. 10101a. In fact, the exemption of this traffic from regulation will actively further several elements of that policy.

The principal thrust of the national transportation policy, and indeed the entire Staggers Act, is to allow competition and the demand for services to establish reasonable rail rates to the maximum extent possible and to minimize the need for federal regulatory control over railroads. 49 U.S.C. 10101a(1) and (2). See also Conf. Rept. 88. In passing the Staggers Act Congress perceived that today, "most transportation is competitive and many . . . . government regulations have become unnecessary and inefficient . . . Modernization of economic regulation of railroads, with greater reliance on the market place, is

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34/ H. Conf. Rept. No. 96-1430, 96th Cong. 2d Sess. 105 (1980) (Conf. Rept.)

35/ *Id*. at 105.

36/ This exemption was affirmed (with very limited exceptions) by the United States Court of Appeals for the Fifth Circuit in *American Trucking Association* v. *ICC*, *supra*.

37/ Section 10505(a)(2) directs the Commission to grant an exemption when it finds that a transaction or service is of limited scope or that regulation is not needed to protect shippers from the abuse of market power. We grant the exemption on the basis that continued regulation is not necessary either to carry out the rail transportation policy of section 10101a or to protect shippers from the abuse of market power. Therefore, there is no need to determine whether an export coal exemption is a matter of limited scope.

essential to achieve maximum utilization of railroads, to save energy and combat inflation." Id. at 79. In sum, Congress recognized that the role of market forces has too long been ignored as an effective check against railroad abuse of market power and that regulation has acted to stifle both healthy competition and the railroads' ability to generate sufficient funds to operate a safe and efficient rail transportation system.

The strong and growing competition for export coal traffic has convinced us that regulation is not necessary to further the national transportation policy. As discussed above, United States coal exports compete in the highly competitive world coal market as well as with alternative sources of energy and other transportation modes. This competition effectively caps the delivered price of American export coal. Beneath that cap, the various parties participating in coal exports must share the economic rents available from the traffic. The broker transshippers who negotiate with the railroads for the shipment of most export coal (and who often can meet their contractual obligations by producing or purchasing coal from mines served by several different railroads)[38] have sufficient economic leverage to prevent the railroads from appropriating all the rents. That leverage ensures that coal rates in an exempt environment will reflect the interplay of the economic strengths of all parties. That result is, we believe, exactly what Congress meant when it enjoined us in the NTP to allow "to the maximum extent possible" competition and demand for services to establish rail rates. Given the relatively equal bargaining power of the involved parties, we see little merit in continuing to handicap the railroads' negotiating posture for the division of available economic rents from export coal. We believe that market competition and natural forces of supply and demand, without interference from this regulatory agency, will establish reasonable and rational rates for this traffic.

Regulation is unnecessary to prevent predatory pricing and practices. See 49 U.S.C. 10101a(13). Predatory pricing is generally understood to mean lowering rates temporarily to drive a domestic competitor out of the market so that the predatory pricer will enjoy monopoly power. Given the size of the railroads involved here, the inadequate revenues of the major coal hauling railroads, and the large number of coal origins, it seems most unlikely that one railroad could exclude its competition altogether from the export coal traffic. But even if that unlikely event were to occur, the remaining railroad would still find its rates constrained by the world market cap. Thus, if carriers (even monopolies) price their services so that the delivered price exceeds the cap, foreign purchasers will obtain their coal volume from an overseas supplier or switch to another energy source. We emphasize that we consider predatory pricing very unlikely, because with or without our regulation, all the railroads have strong incentives to maintain the profitable traffic at maximum levels.

Exemption also will promote the efficiency of the transportation system and better enable rail carriers to earn more adequate revenues consistent with 49 U.S.C. 10101a(3). Exemption will free the railroads to maximize their revenues by pricing on the basis of market demand and each mine's long run marginal cost (including a return on cost of capital). By charging some of their more price-sensitive mines a lower rate and keeping them in the market, the railroads will be able to increase their revenue above what they would realize by increasing prices uniformly, as they have done in the past.[39]

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[38] See Supp. N&W-Chessie, p. 13.

The key to increased efficiency is the fact that an exemption necessarily will encourage the use of long-term contract rates. The railroads argue persuasively that until now the fact that a complaint challenging an export coal rate could result in a Commission-mandated rate reduction has been a strong impediment to the negotiation of contract rates.[40] Moreover, carriers have alleged that shippers have frequently refused to enter a contract without a "regulatory backstop clause" affording them the benefit of any rate reductions secured by their competitors. This in turn undercuts the very certainty which the contract seeks to achieve.

Contracts foster efficiency because they provide the flexibility necessary to develop sensitive and innovative rate and service proposals, and the certainty of future business sufficient to justify new investment. At the same time, they give purchasers the reliable service they need, along with an assurance of price stability. Exemption of export coal from regulation is therefore consistent with the NTP because it not only removes impediments to efficient operations, but actively fosters efficient transportation arrangements. The resulting environment will make it possible for foreign buyers to rely on the United States for their coal, and thus assure the nation's continued place in the world coal market.

Similarly, an exemption will encourage the "honest and efficient management of railroads" we are to encourage pursuant to 49 U.S.C. 10101a(10). Following enactment of the Staggers Act's reforms, the railroads have made substantial progress in pricing competitively, attracting new traffic and monitoring costs.[41] The flexibility created by our action here, which enables the railroads and sophisticated and powerful coal shipper interests to negotiate and divide any available economic rents from world market determined export coal net delivered rates, will ensure that rational ratemaking continues in the future.

Finally, an exemption will aid the development and continuation of effective competition and coordination among rail carriers and other modes. 49 U.S.C. 10101a(4) and (5). We think the marketing flexibility that will result from our action here will free the railroads to arrange intermodal movements where this will prove efficient.[42] Our prediction reflects our experience with other exemptions. In particular, following our exemption of TOFC/COFC traffic in 1981, several railroads implemented rate reductions to improve their competitive positions vis-a-vis motor carriers and other railroads.[43] We believe this exemption may well encourage similar results.[44] Moreover, the inevitable increase in negotiated ratemaking following this exemption will create a transportation system tailored to suit "the needs of the public and the national defense." 49 U.S.C. 10101a(4). As discussed above, an increase in contract ratemaking will enable railroads to develop operating strategies and make capital improvements on a long term basis. The resulting strengthening of our transportation system will aid our national defense posture by providing our trading partners secure supplies of energy.

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[39] See generally Supp. N&W-Chessie. Such action would be consistent with 49 U.S.C. 10101a(11) which encourages rail carriers to rely on individual rate increases, limiting the use of increases of general applicability.

[40] See Supp. NW - Chessie. Indeed, NW - Chessie states (Supp. 3, 10) that there are virtually no pre-Staggers Act contracts for export coal and that even subsequently little long term contracting has been achieved. Although Chessie recently entered into a 30-year contract with members of a consortium building a new port coal terminal (id. at 11) the rate terms are predicated on existing rate levels.

[41] See Arkansas Power & Light Company et al. Petition to Institute a Rulemaking Proceeding - Implementation of Long-Cannon Amendment, 365 I.C.C. 983, 990-991 (1982), petition for review pending in Arkansas Power and Light Company v. ICC, U.S.C.A., D.C. Cir. Nos. 82-1484 et al. See also Conf. Rept. 90.

[42] At the same time, water or coal slurry substitution will act as partial price restraints.

Two principal arguments are made that the national transportation policy requires our continued regulation of export coal. We are not persuaded by either one. First, the Departments of Commerce and State predict that deregulation will result in rates that could depress export coal volumes, jeopardizing our international energy policy, which favors the use of coal by our allies. We do not share their fears because we disagree with the premises of their economic analysis. The two Departments assume that railroads will uniformly raise their rates, and that those uniform rate increases, when added to what the Departments apparently see as the immutable coal producers' share of the present economic rents, will result in delivery prices above the cap set by the competitive world market. The railroads, however, have repeatedly stated that they intend to engage in selective, rather than uniform pricing. We credit the railroads' statements because they make economic sense while we believe the Departments' views are based on the misconception that the parties, especially the railroads, will use the freedom to act irrationally.

The railroads want increased contracting for export coal rates. Such contracts, negotiated with various shipper interests under varying circumstances, by their very nature are unlikely to produce uniform price increases. More importantly, the Departments never explain why they think railroads will blindly impose massive rate increases and thus reduce volume if the railroads' aim is to maximize revenues. Because this traffic is already profitable, we think it is far more likely that the railroads will attempt to help maintain or increase present export volumes, while striving to maximize their revenues on each particular movement.

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[43] See comments of the Department of Transportation, pp. 7-8.

[44] The Coal Exporters Association (comments, p. 19) asserts that deregulation will remove the statutory protections intended to keep rail rates to the rivers for export coal at reasonable levels to the detriment of rail/water competition. But the Association itself concedes (p. 19) that "even under regulation certain of the railroads have kept their rates for export coal to the river so high as to preclude competition by the water carriers". Moreover, it recognizes(p. 20) that non railroad entities, are constructing or proposing coal ports to compete with the ports owned and operated by the railroads. Accordingly, we conclude that continued regulation will not guarantee the rail/water competition that shipper interests desire and that the competition of coal ports -- and the fear that more may be developed -- will effectively constrain unreasonable railroad pricing to the ports.

Given this conclusion, we see no basis for continuing to shield coal producers from fair competition by the railroads. The producers' or transshippers' share of the economic rents from export coal should reflect their economic power, and should not rest upon the fact that another key element in the process--the railroads--are subject to restraint unnecessary in a competitive environment. Thus, the railroads will not be able to price export coal beyond the reach of foreign consumers, except at ruinous cost to themselves. Because we expect the carriers to act rationally, it simply is not reasonable to forecast a decrease in the amount of coal exported as a result of this exemption. Accordingly, an exemption will allow our allies, especially the countries of Western Europe, to place greater reliance on American coal, thus enhancing our common security. Deregulation is consistent with the President's Coal Export Policy Statement because it removes regulatory delay and uncertainty from coal transportation pricing.

Second, we find no basis for the generalized arguments[45] that the exemption might result in unlawful discrimination -- or competive practices involving water carriers -- that are unfair, destructive, predatory or otherwise unlawful. See 49 U.S.C. 10101a(13). In American Trucking Associations v. ICC, supra, the court rejected the virtually identical assertion that the TOFC/COFC exemption could lead to practices proscribed by Section 707[46] of the Staggers Act and 49 U.S.C. 10741(b).[47] It properly explained:[48]

> the exemption does not make lawful any 'competitive practice that is unfair, destructive, predatory or otherwise undermines competition.' Rather, ... it simply exempts the railroads from regulation, thus allowing them to compete. Should the railroads develop sufficient market power to engage in the kinds of destructive competitive practices referred to in Section[s] 707 [and 10741(b)] the exemption will be revoked and regulation restored.

In other words, it is clear that where, as here, exemption is consistent with certain elements of the rail transportation policy, our authority to revoke exemptions in 49 U.S.C. 10505(d) provides sufficient protection against possible future action that could violate the Act.[49]

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[45] See Comments of Coal Exporters Assn., 7-, 78-83.

[46] Section 707 provides:

> with respect to the relationships between water carriers and rail carriers, none of the amendments made by this Act shall be construed to make lawful (1) any competitive practice that is unfair, destructive, predatory or otherwise undermines competition and that was unlawful on the effective date of this Act; or (2) any other competitive practice that is unfair, destructive, predatory, or otherwise undermines competition.

[47] Section 10741(b) provides:

> A common carrier providing transportation or service subject to the jurisdiction of the Commission under chapter 105 of this title may not subject a person, place, port or type of traffic to unreasonable discrimination.

[48] American Trucking Associations Inc. v. ICC, supra, 656 F.2d at 1123-24.

In any event, the harm alleged -- proposing rates intended to channel traffic to the railroads' own coal piers and away from new coal port facilities being developed by the producers[50] -- is not a violation of the discrimination statute. Section 10741(b) -- which prohibits only "unreasonable" discrimination -- clearly does not mandate identical treatment of all similarly situated localities and shippers. In fact, the practice of charging a lower rate for single-line traffic to a port than for joint-line service from a mine origin area to a port served by other carriers has been in existence for more than 50 years.[51] The lower single line rates reflect the very different transportation circumstances involved and the advantages of handling traffic in single-line as compared to joint-line service.

Congress in the Staggers Act retained the right of ports to complain of unjust discrimination.[52] But the protection of port interests no longer is "at the heart of the national transportation policy."[53] To the contrary, Congress explicitly stated that "claims of unjust discrimination may not be used to hamper the development of sound economic rate and service relationships."[54] Moreover, it explained[55] that the Commission should

> exercise its remaining power under Section 10741 only where it is needed to prevent abuses of market power where discrimination cannot be justified by differences in demand for services or costs.

Even under regulation a rate will not be labeled discriminatory simply because competitive conditions naturally favor some shippers (or ports) relative to others.[56] Thus, shipper interests have not shown and cannot show that regulation is required to prevent discrimination or practices that are unfair, predatory or destructive to water carriers.

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[49] Congress did not expect us to be able to predict with certainty the effects of every exemption decision. *Id.* at 1127. To the contrary, the Conference Report (p. 105) explicitly states:

> The conferees expect that ... the Commission will adopt a policy of reviewing carrier actions after the fact to correct abuses of market power.

[50] Comments of the Coal Exporters Association, pp. 82-83.

[51] See Supp. N&W-Chessie-, pp. 30-31.

[52] In other areas, the Commission authority to remove discrimination was severely circumscribed. See 49 U.S.C. 10741(d)-(f).

[53] See Comments of Coal Exporters Ass., p. 79.

[54] Conf. Rept. at 104.

[55] *Id.*

[56] See *Nueces County Navigation District No. 1 v. ICC*, 674 F.2d 1055 (5th Cir), cert. denied, ___ U.S. ___ (1982).

In sum, for the reasons discussed above we conclude that continued regulation of export coal is detrimental to the rail transportation policy and that exemption will be beneficial to the railroad industry, the export coal industry, and the nation.

B. Regulation Is Not Needed To Protect Shippers From The Abuse of Market Power.

The Staggers Act directs us to grant exemptions wherever regulation is not needed to prevent abuses of market power. 49 U.S.C. 10505(a)(2). Thus, the issue is not whether deregulation will give the railroads some market power but whether we conclude that an exemption will result in abuse. We can not reach such a conclusion here.

At the outset, we point out that we may make a Section 10505(a)(2) finding even where there is no effective competition.[57] Therefore, it is significant that in this case the parties have firmly established the strong world-wide competition for our export coal. As has been made abundantly clear,[58] coal from the United States participates in a world-market made up of many large sophisticated buyers who can obtain their coal from several sources. Given those many sources, and the fact that the United States has but a relatively small share of the world market, American rail carriers can not by unilateral action force up the delivered price users will pay for American coal. This fact means that the issue of the potential for market abuse by the railroads must be analyzed in the context of the question of whether the railroads will be able to appropriate all of the economic rents created by the difference in the costs for producing and shipping export coal and the world market price for that coal.

Within this pricing arena in which the world delivered price of coal is highly constrained by competitive market forces, we are confident that the railroads will not price their services so as to reduce American coal production. Opponents argue that railroads would accept the loss of some export coal since the loss would be more than offset for the railroads by an increased return on each ton of coal moved at higher rates. However, opponents' belief is the result of their misktaken assumption of uniform rate increases, e.g. in the NERA model, the railroads are assumed to act like simple monopolists. A simple monopolist must accept the loss of one customer's business in order to raise prices to its other customers. The railroads, however, have persuaded us that they are not likely to act as simple monopolists but will price their services according to the cost and demand characteristics of each particular mine in order to retain the traffic. The railroads have demonstrated that it is not in their economic interest to raise rates to the point where the traffic stops moving. Price competition for export coal is such that even a ten percent increase in the delivered price of American coal can be the difference between obtaining a market or losing it entirely.[59] And it is in the railroads best interest to ensure that American coal continues to be sold abroad.

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[57] Conf. Rept., p. 105. See American Trucking Associations, Inc. v. ICC, supra, 656 F.2d at [illegible] 1125-26.

[58] See, e.g., comments of the Western Railroads and comments of the Department of Transportation.

[59] Interagency Coal Export Task Force Rept., p. [illegible].

The railroads are highly capital intensive and have a large amount of capital invested in the coal industry on which there will be no return if coal is not produced and moved over their lines. Moreover, the railroads depend upon increasing volumes of export coal to amortize their heavy investment and finance new construction. In sum, the railroads' interests closely approximate those of the mines they serve. Rail rates may increase under the exemption, but they are unlikely to increase sufficiently to reduce the volume of export coal significantly or to force the mine owners into a situation where their return on investment would be inadequate.

It is generally conceded that the availability of alternate sources of delivered coal will protect foreign buyers from abuse by the United States.[60] However, as previously noted, those opposed to exemption assert that the railroads will have undue and oppressive market power over domestic coal producers because most coal mines are served by but a single railroad.

We think these fears are misplaced. First, as we discussed above, coal exporters are an extremely concentrated industry with sufficient bargaining leverage to prevent unreasonable pricing by the railroads. Thus, we are unwilling to accept the coal producers' argument that the railroads if exempted will appropriate all the economic rents on export coal. Second, for most coal export traffic, the railroads' direct customer is not the overseas buyer or the operator of a single mine but a large broker or transshipper often who takes responsibility for assembling an order of coal and guaranteeing delivery.

The transshippers often own their own mines (which generally are located in several producing regions of the country) and make purchases from small independent mines.[61] They are able to fill an order from a variety of mines served by different railroads because export coal contracts are rarely mine specific.[62] The railroads' awareness that transshippers are not bound to use the services of any one carrier gives transshippers considerable leverage in their negotiations.

There is also severe interregional competition for export sales. Motor carrier, and particularly, barge competition exists, creating rail/water or rail/truck alternatives. The potential for development of coal slurry pipelines adds to the transportation alternatives. Finally, purchasers have the option of considering other sources of energy, making product competition an important factor. The world price of oil is an essential factor affecting the price and demand for export coal. Consumers may also turn to other alternative energy sources such as nuclear power and natural gas. This rigorous competition substantially restrains railroads from abusing their market power or engaging in monopoly pricing.[63] Moreover, even in the rare instance where a particular carrier might exclusively serve a small shipper that produced and sold export coal from a particular mine under a long term contract,[64] it would be contrary to that carrier's interest to attempt to abuse its market position by raising rates to the point where the traffic stops. Unreasonable rates would discourage foreign buyers from making future coal purchases from mines served by that carrier (for fear of similar rate actions cutting off supply) and could lead to short term traffic losses through the substitution of coal from other sources. We adopt the views of the Department of Transportation[65] that:

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[60] See particularly Comments of Coal Exporters Association pp. 36-37; Comments of Department of Transportation 10-11.

[61] Supp. N&W -- Chessie, pp. 8-13.

[62] Comments of the Department of Transportation, p. 11.

[63] There is strong evidence that competition results in reasonable -- and frequently reduced -- rates, as discussed above. Conrail has reduced its export rates on so called captive coal mine traffic, and N&W and Chessie have not taken several general rate increases on export coal. Supp. N&W-Chessie p. 6. Finally, it is significant that with the exception of a Section 229 complaint, no complaints challenging Western export coal rates have been filed. Comments of Western Railroads, p. 16.

> although an individual mine may be served by only one railroad each customer is not limited to buying coal from a particular mine. Even if a coal customer is constrained to buy a particular type of coal available from only one source served by one railroad, a coal exporter has the power to direct other portions of its coal export or domestic business to other carriers in order to obtain satisfactory rate and service terms from that railroad.

In conclusion, the exemption of export coal will place the parties involved in exporting coal on an equal footing[66], and will leave the producers and carriers free to negotiate a division of available profit or economic rent. We expect that, following exemption, the railroads will differentiate among the mines they serve and set their rates in an area between an individual mine's long run marginal cost of extraction at the current cost of capital and the world market price.[67] The railroads have long differentiated their rates among the mines they serve and are fully equipped to do so once regulation ends.[68] Although, under exemption, the railroads sometimes may obtain more of the available profit than they currently do, it is in the carriers' long range self interest to encourage the shippers to expand production. Both they and the shippers have a common interest in bringing to market as much coal as the market will absorb. Regional and world competition and shipper transportation and marketing alternatives, as well as the carriers' rational self interest, will all constrain the railroads from abusing such market power as they may possess. Regulation, therefore, is not needed to protect shippers from abuse of market power.

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[64] Absent such a contract, of course, the producer could sell domestically, thus obtaining the benefits of our regulation of maximum reasonable rates. Up until now export coal has constituted only a small percentage of the United States coal shipped.

[65] Comments, p. 12.

[66] Of the parties involved (railroads, producers, transshippers and ocean carriers) only the rail carriers are regulated.

[67] Economic rent will be divided in accordance with the relative bargaining power of the parties involved in particular cases. In some cases the shipper will have more leverage; the converse will be true in others.

[68] Sufficient information to permit the differentiation should be readily available, because the individual producer would have a strong incentive to discuss its situation with the railroad and inform it of anything (including its extraction costs as they change over time) which would warrant a lower rate. Should misapprehension lead to too high a rate, temporary suspension of production should result in a rate which would return the mine to market.

Finally, we note that two other important safeguards exist to protect against any abuse of market power. First, exemption will mean the complete removal of all antitrust immunity.[69] Even shipper interests concede[70] that the antitrust laws, particularly Section 2 of the Sherman Act, provides assurance that levels of rates and services for exempt transportation do not become unreasonable.

Second, the railroads know that if they engage in an abuse of market power, we may revoke our decision here pursuant to 49 U.S.C. 10505(d) and restore regulation.[71] This will be a strong incentive to the carriers not to abuse their market power even if a particular railroad were to develop sufficient leverage to be able to do so.

For these reasons, we do not believe that the exemption of export coal transportation will result in abuse of market power by the railroads. Rather, exemption will allow the railroads to respond flexibly to the rapidly changing circumstances of the world coal market and will encourage long-term contracts and the efficiency that negotiated ratemaking brings.

VI. STATEMENT OF ENERGY IMPACT AND ENVIRONMENTAL CONSIDERATIONS

The Environmental Assessment (EA) prepared by the Commission's Section of Energy and Environment demonstrates that the impacts of an exemption upon the environment and upon energy consumption are not likely to be substantial. We agree with this conclusion.

First, the EA examines the possibility that rate levels will fall under an exemption. An exemption would not significantly increase a rail carrier's freedom to decrease rates, however. Under the Interstate Commerce Act, no rate can be found unlawfully low if it contributes to a carrier's going concern value (Section 10704(a)(2)). The EA is correct that even without an exemption current rates on export coal could be lowered dramatically without reaching that point, and we do not anticipate an exemption would trigger such dramatic reductions.

The EA next examines possible rate increase levels resulting from deregulation of export coal. Because of the interdependence of domestic and export coal production and transportation, assumptions were made as to both the domestic and the export coal transportation rate. The mine mouth price of coal was assumed to be constant. The EA predicted what would be the effect on production and transportation of U.S. coal for export given certain assumptions about rail price increases for 1985, 1990, and 1995 using the International Coal Trade Model and the Coal Supply and Transportation Model.

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[69] Our exemption decisions traditionally have removed antitrust immunity. See Improvement of TOFC/COFC Regulation, 364 I.C.C. 731, 736 (1981). Here, the Department of Justice has requested the complete revocation of all immunity and the carriers do not object. Immunity will be revoked for all aspects of export coal transportaion including the collective setting of car hire charges.

[70] See Comments of Coal Exporters Assn. pp. 97-98.

[71] American Trucking Assn v. ICC, supra, 656 F.2d at 1123-24. 1127; McGinness v. ICC, supra, 662 F.2d at 857, n. 9. See also Conf. Rept. 105 (The conferees expect that the Commission will adopt a policy of reviewing carrier action after the fact to correct abuses of market power).

The first case, called the base case, assumes that there would be no increase in rates for either domestic or export coal. Any changes in production and transportation under the base can be attributed solely to other factors--such as projected changes in international markets--and not to the exemption. This case is useful, however, in assessing what changes are likely to occur even without the exemption so that potential changes attributable to the exemption can be isolated.

The second case, the composite scenario, assumes that rates on export coal will increase 10 percent a year. At the same time, rates on domestic coal will increase as allowed in the Notice of Proposed Rulemaking in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines - Nationwide. The EA determined that if the railroads impose the increases allowed under those guidelines until they reach revenue adequacy, this will result in a weighted average annual rate increase of approximately 5.5 percent.

The EA then concluded that production would be affected as follows:

TABLE 2

PROJECTED COAL PRODUCTION 1985 - 1995
UNDER ALTERNATIVE RAIL RATE SCENARIOS
(in millions of tons)

SCENARIO	1985	1990	1995
Base Case			
Export	109	143	175
Domestic	783	910	1,072
Total	892	1,053	1,247
Composite			
Export	94	113	110
Domestic	778	886	1,034
Total	872	999	1,144

Clearly, substantial across-the-board increases in rail freight rates for export coal will decrease the demand below levels which would have been expected given stable rates. The EA concludes that under the composite scenario, increased rates could result in production decreases in some localities. But the decrease in production would also result in beneficial impacts on the physical environment such as improvement in air and water quality, reduced energy consumption, reduced noise and accident levels due to decreased mining and transportation activity. The EA shows that the exemption will not generate significant impacts to the physical environment and does not warrant preparation of an Environmental Impact Statement.

We have carefully examined the EA and we generally agree with these conclusions. Nevertheless, we would like to point out that for a number of reasons the EA overstates the environmental impacts which are likely to flow from the exemption.72/ Given the price sensitivity of the export coal market, we do not believe that the carriers will find it in their interest to price above levels which will be lawful under various Staggers Act rate freedoms and coal rate guidelines which are eventually adopted.

72/ We would also criticize the EA's composite scenario for not isolating the increases which are attributable solely to exemption. We should not attribute all of the results of these increases to the exemption, but only the impact of the net difference not available under regulation. Obviously, the EA is making certain "worst-case" assumptions.

Even if they do so they will be free to charge different rates to different shippers to the extent which is necessary to retain this profitable traffic. Each shipper of export coal is large enough so that a carrier will have every incentive to examine the effect of a particular transportation rate upon the shipper's ability to compete in the market. And as the railroads have pointed out, the shippers are constantly educating the carriers on this subject. We expect carriers to use their new pricing freedom rationally so as not to price themselves out of the market.

The EA also assumes that the mine mouth price of coal will remain constant. We predict, however, that because the demand for export coal is so price sensitive, transportation rate increases will in some cases force suppliers to reduce the mine mouth price so that the delivered price of the coal to foreign ports remains competitive. As previously discussed in this decision, the exemption will give the carriers greater leverage to deal on a more even basis with mining companies and ocean carriers and transshippers for a relatively greater share of a total profit which is constrained by the competitive world coal market.

In conclusion, even if the worst-case rate increases postulated by the EA occur, there will be no substantial impacts on the environment, or upon energy conversation or efficiency. Moreover, we think the impacts of the exemption projected by the EA are overstated essentially because the EA has not assumed rational behavior on the part of the railroads. Rational behavior would result in the exemption having little or no effect on the volume of export coal movements.

REGULATORY FLEXIBILITY

Because of our special concern with the effect of this proceeding on small entities, we specifically encouraged them to participate in the oral argument. 47 Fed. Reg. 19813 (May 7, 1982). Our Office of Communications took steps to asure wide publicity to small entities, but no substantial participation resulted.

Having reviewed the record, we certify that the exemption of export coal from regulation will not have a significant impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act. The purpose and effect of this action is to reduce regulation. It imposes no new reporting or other requirements directly or indirectly on small entities. The impact, if any, will be to reduce the amount of paperwork, tariff filing, and related activities.

Based on the record before us we find that:

1. Regulation of export coal is not necessary to carry out the rail transportation policy;

2. Regulation of export coal is not necessary to protect shippers from the abuse of market power;

3. This decision will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Based on the statutory findings we have made under 49 U.S.C. 10505, export coal moving through United States ports including Great Lakes ports is exempt from the requirements of 49 U.S.C. Subtitle IV.

2. Interested person are invited to submit comments within 30 days on the question of whether the transportation of export coal by railroad to Canada and Mexico should also be exempted.

3. This decision is effective on September 12, 1983.

By the Commission, Chairman Taylor, Vice Chairman Sterrett, Commissioners Andre and Gradison. Chairman Taylor dissented with a separate expression. Vice Sterrett and Commissioners Andre and Gradison commented with a separate expression.

Agatha L. Mergenovich
Secretary

(SEAL)

CHAIRMAN TAYLOR dissenting:[1]

I appreciate the majority's summarization of the proponent railroads' comments[2] but feel that perhaps a more neutral approach would provide a better basis on which to rationally decide this important case. Consequently, I will begin and conclude with an analysis of this proposal under 49 U.S.C. 10505 and the legislative intent of the Staggers Act.

The key to assessing the merits of a proposed exemption, insofar as the statutory criteria are concerned, is the recognition that Congress intended the Commission to retain only that measure of regulation necessary to protect shippers, especially captive shippers, from the abuse of market power. Congress specifically expressed its intent that regulation be continued in these situations where competition is absent and market forces cannot come into play.[3]

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[1] Before discussing the issues, I want to point out that my opposition to this proposal is shared by Commissioner J.J. Simmons III, who, before leaving the Commission, actively participated in the oral argument and in our deliberations on the merits of the proposal. In the determinative round of voting which culminated on March 3, 1983, and in which a 3-2 majority voted to grant the exemption, Commissioner Simmons voted, on Feb. 28, 1983, to deny the exemption stating: "If I am in the minority and the decision is revised so as to grant the exemption in whole or in part, I wish to be shown as dissenting and having voted to deny the exemption in its entirety." It is my firm belief that Commissioner Simmons' vote is a proper and integral part of the Commission's determination of this matter.

[2] See, e.g., majority decision, at pp. 3-8, 10-16, 18-31, 38-40, 51, 58, 61, & 63.

The legislative history of the Staggers Act reflects the particular concern of Congress over captive coal traffic. The Senate Committee Report directs the Commission to ensure that coal traffic bears only its fair share of costs, and that "higher rated captive traffic is not unduly burdened."[4] The Conference Committee Report emphasizes "the encouragement and promotion of the transportation of coal by rail ... at rates which do not exceed a reasonable maximum where there is an absence of effective competition."[5] No other commodity was so singled out by Congress.

Accordingly, the central question here is whether, in the absence of regulation, competition in the world and domestic markets would both (i) hold coal rates to reasonable levels, and (ii) encourage and expand the transportation of export coal. My analysis of the evidence, including the comments filed by shippers, receivers, government agencies, and others, together with several reports prepared by the Commission's staff, all lead to the inevitable conclusion that because the necessary competition is not present, neither of the foregoing results will occur if the exemption is granted. Actually, the evidence of record strongly indicates that granting the exemption will result in increased rates, together with decreased demand and production. Therefore, the discussion that follows will consider the interrelated effects of exempting export coal movements from all I.C.C. regulation, including rate provisions and car hire/car service obligations.

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[3] See especially S. Rep. No. 470, 96th Cong., 1st Sess. 43 (1979) which states that the exemption power should not be used "at the expense of captive shippers who have no reasonable transportation alternatives."

Also see the discussion set forth on page 17 of that report indicating the Committee's concern with the magnitude of rate increases on coal movements and the importance of energy considerations.

[4] *Id.* at 7-8. It should be noted, at this juncture, that in expressing its concern for captive coal traffic, Congress did *not* distinguish between domestic and export coal.

[5] H. Rep. No. 1430, 96th Cong. 2nd Sess. 80 (1980).

Turning now to the issues, let me begin by stating that while I agree there is competition in the international coal export market[6], I am not at all convinced of its relevance as an effective constraint on rail ratemaking for domestic movements from mines to ports. First, the relationship between competition among international suppliers and domestic movements was not directly addressed in our Market Dominance proceeding.[7] The Commission there concluded only that potential sources of competition should not be excluded from consideration. Thus, world competition is only one factor among many to be considered.[8].

Of even more importance is the fact that competition in the world export market has only limited relevance in this proceeding. The "source" of such world competition is too remote and takes place entirely outside the U.S. Any analysis must consider the effects of an exemption on both rates and service, and at best, world competition will only set a price cap for U.S. coal in foreign countries, i.e., a maximum price above which coal will not move for export.

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[6] There is considerable question regarding the effectiveness of competition in the movement of metallurgical (met) coal to Western Europe. The U.S. supplies 55 percent of Western European met coal, and is considered the "swing supplier." The major alternative suppliers, Australia (labor problems), Poland (strikes and martial law), South Africa (political unrest and self-imposed quotas), and the U.S.S.R. are not considered reliable substitutes for U.S. coal.

[7] Ex Parte No. 320 (Sub-No. 2) Market Dominance Determinations and Consideration of Product Competition, 365 I.C.C. 118(1981) (remanded, Western Coal Traffic League and Its Members, et al. v. United States of America, 5th Cir. No. 81-4257 (Dec. 8, 1982). The court held that the Commission was statutorily precluded from considering geographic and product competition in making market dominance determinations). Rehearing en banc granted March 7, 1983; oral argument scheduled for June 6, 1983.

[8] But see, Sec. 205(a)(2)(D) of the Staggers Act which specifically excludes consideration of imported coal as competition in any market dominance determination regarding domestic coal rates.

This "price cap," however, will neither ensure a reasonable division of profits between the railroads and the coal interests, nor enable the captive shipper to move its coal if a railroad, once freed from its common carrier obligation, determines not to serve such shipper at all or to condition service upon unreasonable rates. That nearly all coal shippers are captive is undeniably demonstrated by the record, which reflects neither intra nor intermodal competition in domestic movements for export coal. Over 95 percent of individual U.S. mines producing export coal are served by just one railroad. In the East, the CSX and the N&W[9] effectively divide the market. In the West, the Union Pacific participates in virtually all export coal movements, while the Atchison, Topeka and Santa Fe participates in a limited number of these movements.[10] Most traffic, especially in the East, is handled by a single railroad from mine to port. Railroads are in a position to exact substantial premiums without fear of diverting traffic to other carriers.

There is no effective intermodal competition. Pipelines do not yet exist for the transportation of export coal, and truck competition is not economically practical for large shipments or long distances.[11] Barge transportation almost always involves a prior movement by rail, which makes the railroad indispensable to the water carrier's ability to carry coal. This point has not been lost on the railroads. For example, until last summer, rates on coal movements to the river system were set higher than those to the East Coast, thus assuring that traffic moved all rail, and in most instances, to railroad-owned port facilities. However, because the shippers and competing barge lines had recourse under the Interstate Commerce Act, the railroads dropped their rates to the river to the domestic level.[12]

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[9] Now a subsidiary of Norfolk Southern Corporation.

[10] At the time the record closed, the Burlington Nothern had not developed an export market for its Powder River Basin coal. See text *infra*.

[11] The statistic of the majority regarding the 13% truck movements is 13% of total coal production. There is no indication of whether any of this is for export.

But, under the exemption proposed here, the railroads could effectively eliminate all barge participation in export coal traffic, and thus adversely affect the New Orleans gateway, either by setting a prohibitively high rate for coal movements to the water connecting point vis-a-vis the rates established for all-rail movements, or by refusing to provide any service at all to water-connecting points for export coal movements. The railroads have a powerful incentive to eliminate barges as a competitive alternative so that more and more export coal will move via all-rail service, often to export coal facilities owned and operated by the railroads. As a result, insofar as the barge alternative is concerned, the export coal exemption can only be regarded as truly anti-competitive.

Moreover, geographic and product competition within the United States is neither a counterbalance nor a solution to the problem. The coal producing regions of the U.S. do not compete with each other for most of the export market. According to the railroads' own testimony, the vast coal reserves now available in the Powder River Basin (Montana and Wyoming) are a very long distance from port (over 1,000 miles) and the coal in such reserves is not of export quality, because its energy value is less than 10,000 BTUs and it has a relatively high moisture content. The coal from Ohio, Western Kentucky, and Illinois is not of met quality and has too much sulfur for all but a small part of the steam coal export market. Coal from Colorado, Utah, and New Mexico goes to Japan, where there appears to be some competition with eastern coal. However, these western reserves produce no met coal, and the delivered price to Japan of eastern steam coal is more than $20 per ton higher than the delivered price of coal from New Mexico, Utah, and Colorado. Therefore, competition between the two sources is minimal. Almost all of our steam and met coal exports to Europe move through Atlantic ports.

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[12] See Complaint No. 38802, Water Transport Assoc. v. The Chesapeake and Ohio Railway and Norfolk and Western Railway Company.

The premise underlying the argument that export contracts can be freely filled from mines on more than one railroad is also unrealistic. First, export tonnage is frequently a blend of coal from several mines, and many times, some mines are on one railroad, some on another. Second, for a shipper to be able to substitute tonnage from a mine on a second railroad, certain conditions must be met, i.e., the tonnage must be available and not already committed to a long-term contract, the extraction costs must be relatively the same, and the tonnage from the second mine must be technologically substitutable for the tonnage from the first. Shippers point out that the chance for such substitution does not usually occur, especially since the Chessie hauls primarily met coal and the N&W primarily steam coal. Third, there must be no price leadership, in that if one railroad raises its rates, the other will not, or at least not to the same level. It appears highly unlikely that all three of the foregoing conditions would coalesce, and even if they did, the advantage would accrue only to the particular shippers affected. The fact remains that ninety-five percent of the mines producing export coal are captive to the railroads that serve them.

The argument that big shippers can play one railroad against another (i.e., by substituting tonnage from mines served by more than one carrier) is still less convincing, even were one to ignore the problem of lack of substitutability discussed _supra_. When a shipper negotiates with a railroad, its corporate affiliation is less important than its access to alternate transportation. There are over 100 companies involved in the export coal trade. Although some of the shippers are large, with connections to still larger entities, only twenty-four percent of the mines served by the Chessie System and the N&W are controlled by operators having mines on both railroads. As for the West and the Mid-West, there appears to be virtually no possibility of substitution between railroads at the present time.

Therefore, contrary to the suggestion of the railroads, the adverse consequences of granting the exemption would not be offset by theorizing that (i) the railroads and the coal suppliers would negotiate as "partners," or that (ii) big shippers could exert more bargaining power than the railroads.

In light of the lack of any form of domestic competition, it cannot be argued that the transportation of coal from mine to port is a joint venture where profits are distributed according to the percentage of equity participation. Instead, such transportation is an undertaking in which the parties' interests are the same only in the broadest sense, i.e., getting the coal to market. However, in the only sense that is germane here, each participant is solely concerned with maximizing its own profit. Because most mines are served by only one railroad, and because many mines may be on that one railroad's line of track, it is perfectly possible for such a railroad to maximize its profit at the expense of one of the shippers it serves. To illustrate, such a railroad could easily recapture business lost at one captive mine from a second mine that has greater production capabilities and/or lower production costs than the first.

To be sure, if coal does not move, neither the railroad nor the coal producer makes any money. However, the magnitude of the loss is not the same for each. For example, each of the two major eastern railroads has over 200 mines on its rail lines. In any negotiation, each mine is bargaining for all of the profit which can be made from that mine. The railroad, on the other hand, is bargaining for profits on only one of several mines that it serves, many of which may be located on the same line of track. Thus, in the negotiating arena, only a relatively small share of the railroad's profits will be at risk.

Clearly, the railroad can rely upon the traffic from other mines on its rail lines and the profit from other commodities it carries to mitigate the loss from its failure to agree with a particular mine, and while so doing, the railroad will remain secure in the knowledge that the coal from such mine must move eventually, if at all, and then only over the railroad's trackage. If the mine does not ship, some other mine on the carrier's line may increase the amount it exports, thereby allowing the railroad to gain a share of the profit from that transaction. Because the individual mine has, for the most part, nowhere else to turn, it will be forced to reach agreement with the railroad or not produce coal. Thus, under the scenario contemplated by the proposed exemption, the railroad would be in a strong position to capture most or all of the individual mine's profit, since the latter's rate of return would effectively be determined by the carrier.[13] Furthermore, given a lack of intermodal and geographic competition, even those few suppliers which could exert significant bargaining power would not protect the interests of the many, nor would they have any incentive to protect the interests of their competitors.[14]

Also, it should be noted here that the record is devoid of any concrete evidence in support of the contention that regulation imposes a chilling effect upon contracting. Hundreds of coal contracts have been filed with the Commission, and the railroads have not evidenced a single instance where they have lost a contract because a shipper has insisted upon a "regulatory backstop" clause. Nor have the railroads indicated what shippers have asked for such a clause or how many times the request has arisen in negotiations. None of the railroads' shipper witnesses testified that they have demanded a "backstop" clause, whereas the shippers opposing the exemption testified that they had never even heard of a "backstop" clause, much less insisted upon one.

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[13] The railroads have stated that they will set their bargaining according to the mine's cost of extraction rather than their own cost of operation.

[14] In fact, as some railroads lease coal producing land to mines, the closure of another mine would only serve to increase royalties to the railroad from its own land. See discussion in text infra.

It should be noted too that the railroads already exercise a substantial measure of ratemaking flexibility.[15] The Commission does not have jurisdiction to examine maximum rate reasonableness unless we first determine that a railroad has market dominance over the transportation to which a particular rate applies, 49 U.S.C. 10701a(b)1 and 10709.

Furthermore, in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, Nationwide (not printed), decided February 8, 1983, we published a carefully crafted proposal for prescribing maximum reasonable coal rates in instances where railroads exercise market dominance over coal traffic. That proposal reflects the dual concern of Congress that captive coal shippers be protected from abuse and that the railroad industry achieve revenue adequacy.[16]

However, quite apart from the ratemaking flexibility proposed in Ex Parte No. 347 (Sub-No. 1), the railroads have stated that they will, given the export coal exemption, engage in discriminatory pricing based on each mine's long-term marginal cost. This discriminatory pricing, as contrasted with differential pricing, will be completely free of regulation and will adversely affect the production of export coal. The natural result of setting rates according to the cost of extraction is to transfer from the mine to the railroad those returns from the production of coal which exceed the mine's long-term marginal cost. A producer who knows that his profits are captive to the carrier has no reason to expand.[17] Appendix A to this dissent sets forth, by example, an illustration of how coal production could be reduced while railroads still maintain maximum returns. In any event, regardless of whether the railroads extract monopoly profits by resort to either simple or discriminating monopoly power, export coal production can predictably be expected to decline over the long run.

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[15] From 1977 through 1981, the average railroad freight charge increased 65.9 percent while the value of coal, per the F.O.B. mine price, increased only 31.2 percent.

[16] The proposal recognizes the need for differential pricing if railroads are to achieve revenue adequacy, thereby, providing the railroads with broad ratemaking flexibility. The approach taken is one of constrained market pricing.

Also of importance is the fact that the effects of the exemption extend far beyond profit and loss to coal shippers and carriers. It is impossible to separate out the extensive foreign and domestic ramifications. While the railroads supplied no economic calculation of the effect on the volume of export coal that their actions under deregulation will have, the majority of the comments and the Commission's own Environmental Assessment Statement (EA) support the conclusion that the exemption and the concomitant rate increases will result in a decline in demand for export coal.

In contrast, Section 203 of the Staggers Act (49 U.S.C. §10701a(e)(2)(B)(iii), i.e., the Long Cannon Amendment) mandates consideration of the impact of a proposed rate or rate increase on the attainment of national energy goals when the Commission determines whether to investigate certain rate proposals. As explained in the Conference Committee Report, the national energy goals include reduction of dependence on foreign energy sources. Further, "[t]o reduce dependence on foreign energy sources this country must stimulate utilization of its abundant, indigenous coal reserve."[18] Consideration of our national energy goals will no longer be a factor in view of the action taken by the majority in this proceeding.

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[17] A more efficient coal producer will have lower production costs, and therefore will be able to absorb greater transportation charges while remaining competitive in the world market. At the same time, the less efficient producer will be unable to absorb equivalent transportation charges. Consequently, transportation costs will dictate coal prices, not production. The efficient producer who will be punished by paying higher transportation charges than his less efficient competitor will compete only on an equivalent footing with less efficient producers. Thus, the efficient mine will not have a cushion to decrease its price and compete more effectively, nor will it have the entrepreneurial incentive to expand production in return for increased profit.

Domestically, a diminishing demand for export coal translates immediately into reduced growth in production in coal supply regions. In fact, the Commission's EA composite case shows that by 1985, Virginia, Utah, and Colorado will experience a complete loss of all export production directly as a result of the declining demand for export coal brought about by increased transportation rates. The EA also indicates that by 1990, there will be substantial declines in the coal productivity of Southern West Virginia, Alabama, and Oklahoma, and that by 1995, New Mexico will lose its entire export coal market. Needless to say, these losses will have a severe adverse impact upon the nation's balance of trade, upon primary and secondary employment levels, upon local and regional tax bases, and upon the communities and families dependent on those mines which are forced to decrease or stop production.

In addition to the foregoing economic and social effects, a grant of the exemption is in direct conflict with the Administration's efforts to stimulate demand for the export of U.S. coal to our allies in the Pacific Rim nations and in Western Europe,[19] and with the President's policy statement to our allies that foreign consumers be allowed complete, open, and nondiscriminatory access to the U.S. coal market.[20] Foreign customers are greatly concerned with the stability of pricing and the reliability of supply. The numerous comments forwarded to the Commission from foreign governments and coal purchasers in countries such as Japan, Spain, Brazil, Italy, the Netherlands, and Ireland all express the strong fear that price increases and a lack of stability in the delivered price will reduce the attractiveness of U.S. coal as a reliable source and as an alternative for not only foreign coal, but also for OPEC oil and Soviet gas. Significantly too, these foreign markets, once lost, cannot be easily regained.[21]

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[18] H. Rep. No. 1430, 96th Cong. 2d Sess 95 (1980).

[19] These actions are part of an integrated effort which includes improvement in port and waterway facilities.

Moreover, as recognized by the Departments of State and Commerce and the International Trade Representative, it is important to our national security that both ourselves and our allies have a secure, economic, and competitively priced alternative to unpredictable supplies of imported energy. In derogation of this objective, the proposed exemption, by shifting profit from producer to carrier and precipitating a long-term decline in coal exports, would undercut a key element of U.S.

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[20] The President's "Coal Export Policy Statement" of July 17, 1981. A foreign purchaser could plausibly conclude that the deregulation of the export market, while leaving domestic coal regulated, is a measure aimed at extracting profits from overseas consumers. In fact, the railroads have confirmed this impression. See the transcript of oral argument, TR 54, 55, 218; see also the Reply Verified Statement of Gould and Landes at 7-8: "Higher prices for delivered coal would be borne by foreign consumers, while U.S. railroads would gain. ...[T]his transfer makes the U.S. better off." Such a conception of the nature of the U.S. commitment to coal exports is clearly not consonant with the President's policy statement.

[21] For a complete discussion on this point, see text infra, at "Revocations," and the comments of the Departments of State and Commerce and those of foreign purchasers.

international energy policy,[22] impair the health of our mining industry, jeopardize the jobs of thousands, and substantially weaken, if not eliminate, a potentially important factor in the restoration of a favorable balance of payments for the United States.

In addition to the glaring defects in the majority's position on the effects of "competition," this decision is also subject to numerous oversights and procedural deficiencies.

ANTITRUST IMMUNITY

Certainly no exemption should be authorized which retains antitrust immunity. However, let no one assume that the antitrust laws will protect shippers from the abuse of market power. The most that the antitrust laws can do is to prevent collusion among existing competitors. The holder of a lawful natural monopoly generally is free to set its rates and provide its services in the manner deemed most profitable.[23] The carriers appear to be immune from antitrust actions with respect to any traffic, such as export coal, which has always been captive. The courts cannot provide the regulatory supervision necessary to curb abuses.

THE RAILROADS' MODIFIED PROPOSAL

Recognizing the serious problems inherent in an across-the-board exemption, the N&W, in a later pleading, proposed that any exemption be limited to the rate regulations of 49 U.S.C. 10701-10712. This would have retained Commission jurisdiction in such critical areas as car hire and service (especially 49 U.S.C.

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[22] See also United States Department of Energy, Interim Report of the Interagency Coal Export Task Force, Jan., 1981 (DOE/FE-0012) which stated that the role of the United States in future coal trade "depends upon the buying strategies of the consuming nations, the policies and prices of competing exporters and the actions taken by the United States to maintain reasonable prices, prompt delivery and dependable quality."

The Commission's EA also predicts, at 51, that "U.S. shares of both the European and Pacific Rim markets are projected to decline significantly."

[23] Berkley Photo, Inc. v. Eastman Kodak, Co., 603 F2d 263, 297 (2d. Cir. 1979).

11126), the commodities clause (49 U.S.C. 10746), the war powers clause (49 U.S.C 11128), the contract rate provisions (49 U.S.C. 10713), and the common carrier obligation (40 U.S.C. 11101(a)) to name only a few. However, the majority decision rejects this modified proposal, but since the N&W's suggested limitations have been addressed only summarily in the majority's analysis of the National Transportation Policy, it is difficult to determine if the impact of their removal was seriously considered.[24]

For instance, as discussed supra, with the demise of the common carrier obligation, what incentive is there, in these days of unit trains, for a railroad to drop and pick up a few cars at the site of a small family-owned mine in Appalachia? Although many such mines have already been shut out of certain export markets because of high transportation costs (which can run as high as one-third to one-half of the purchaser's costs), the few that remain will face inevitable exclusion from such markets by virtue of the exemption granted herein.

Congress specifically recognized the problem of obtaining cars in 49 U.S.C. 11126(a), which requires railroads to make "a reasonable distribution of cars for transportation of coal among the coal mines served by it [the railroad] whether the mines are located on its line or are customarily dependent on it for car supply." Thus, by imposing an obligation to supply cars, in tandem with the common carrier obligation and various rate regulations, Congress sought to ensure continued participation in the market, not just for mines that a railroad chooses to serve, but for all mines.

Did the majority also consider the impact of removing the commodities clause limitation on the exemption granted? Railroads own enormous amounts of coal, most of which they received in the form of grants from the government. Three railroads (i.e., the Burlington Northern, the Union Pacific, and the Santa Fe) own over 16 billion tons of coal reserves, which approximates 25 percent of the total non-federal coal reserves located in the Western States. Recently, these railroads have been active in marketing their coal, but the commodities clause, 49 U.S.C §10746, prohibits them from transporting it. However, the exemption granted by the majority will void the statutory prohibition against such railroads directly transporting their own coal to an export gateway. As a result, with the exemption, the railroads can determine which mines will receive service, and thus they could decide that export coal will come only from their own mines. Under the exemption, it would appear that coal-owning railroads can now mine their own coal and haul it in their own cars, over their own tracks, to their own piers for export.[25] As a consequence, independent coal producers will instantly, upon the exemption becoming effective, be confronted with a legal vertical monopoly against which it will be very difficult to compete.

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[24] For a contrast, see the Commission's recent decision exempting boxcars, wherein these questions were discussed at length and it was emphasized that jurisdiction was being retained to protect against shipper abuse.

LACK OF AN ENVIRONMENTAL IMPACT STATEMENT

In the majority's unexplained rush to issue this decision, the required environmental impact statement (EIS) and energy impact statement (SEI) have both been omitted. The purpose of an EIS and an SEI is to enable the Commission to consider fully the environmental and energy impacts of its decision. However, when voting was concluded in early March and the exemption was granted, the Commission had nothing before it on this issue.[26] Ironically, however, also in March of this year, the entire

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[25] Some railroads are currently investigating the desirability of entering into the ocean portion of export coal transportation.

[26] The threshold environmental analysis was prepared in March of 1982 and recalled by the Director of the Office of Transportation Analysis in November of 1982, because the analysis was insufficient to reach a conclusion that no significant adverse impacts were likely.

Commission issued a notice of intent to prepare an EIS in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide, supra.[27] That notice found that a significant environmental effect arises out of any major change in coal rate regulation, and as a result, several possible effects of coal rate increases were listed. In fact, the EIS in Ex Parte No. 347 (Sub-No. 1) stated that it would "consider the effect of the proposed action on potential overseas demand for domestic coal," and on how the proposed rate guidelines "might . . . affect other important considerations such as export coal policy."

Thus, the Commission has recently acknowledged, as a matter of public record, that the export coal market and the environmental manifestation of any changes in that market are not economically isolable from the domestic coal transportation market. The National Environmental Policy Act (NEPA) requires federal agencies to produce a detailed environmental impact statement (EIS) for "major Federal actions significantly affecting the quality of the human environment." 42 U.S.C. 4332(2)(C). See Aberdeen & Rockfish R. Co. v. SCRAP., 422 U.S. 289, 318-319 (1975).

The logic of the above NEPA analysis also applies to the requirements of the Energy Policy and Conservation Act (EPACA), 42 U.S.C. 6201 et seq., which requires the Commission, where practicable, to include in any major regulatory action a statement of the action's probable impact on energy efficiency and energy consumption. 42 U.S.C. 6362(b). A statement of energy impact (SEI) is certainly indicated here, because the exemption affects coal rates, because the Commission's regulations generally require an SEI in rulemaking proposals affecting carrier operations, 49 C.F.R. 1106.5(a)(9), and because the Commission acknowledged potential energy impact in the export exemption rulemaking notice. 46 Fed. Reg. 44532 (Sept. 4, 1981).

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27. 49 Fed. Reg. 9766, March 8, 1983.

The Commission has thus formally acknowledged that as to energy consumption and environmental considerations, the export coal market is inherently intertwined with the domestic market. Yet, to avoid preparing an EIS in this proceeding, the majority has found that exempting export coal movements from regulation is not a major federal action significantly affecting the quality of the human environment or the consumption of energy. Such a finding is manifestly indefensible!

The assessment statement (EA) on which the majority's above conclusion is based is seriously flawed and incomplete.[28] First, the EA is based entirely on the assumption that the only effect of the export coal exemption will be an increase in rates.[29] While I certainly agree that this will be the primary result, the possibility of selective decreases, especially on movements from railroad-owned sources, combined with service discontinuances to others, cannot be discounted. The purpose and result of such selective decreases would be to shift supply sources from current producers to railroad-owned mines. Such a direct manipulation of the supply market, while perhaps a reasonable reaction on the part of the railroads to a continuing coal surplus, could only be accomplished if all regulation were removed. Therefore, the failure of the EA to address the effects of decreases in rates and the resultant shifts in supply sources is a major defect.

Also, the assessment addresses only indirectly the relationship between export and domestic markets. Export coal rates (and delivered prices which include those rates) have a clear "secondary impact" on the domestic coal market and coal production in general. This secondary impact flows, in part, from the fact that the amount of coal exported can affect the quantity and price of coal available for domestic use, as well as the price at which railroads would be willing to move domestic coal. These effects, in turn, help determine whether domestic coal users will switch to alternate fuels. Thus, while the domestic environmental effects of exempting export coal may not be as direct as those resulting from the Commission's proposed guidelines in Ex Parte No. 347 (Sub-No. 1), they are, nevertheless, closely related and reasonably foreseeable. See 40 C.F.R. 1508.8. Under NEPA, an agency must discuss all such secondary impacts having significant adverse environmental effects. See, for example, South Louisiana Environmental Council v. Sand, 629 F.2d 1005, 1016 (5th Cir. 1980).

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[28] The instant EA, which was prepared subsequent to the March 3, 1983 decision to grant the exemption, warns that impacts are "discussed in general terms because of (1) the absence of knowledge concerning the exact location of extraction activities, (2) the lack of adequate methods to quantify impacts, and (3) the absence of precise or consistent information..."

[29] "[We] have further limited our analysis to a study of the impacts of future rate increases." EA at 2.

Because of the limited rate increase scenarios studied in the EA, I can only conclude that its overly broad findings are not supported by reasonable evidence. The fact of the matter is the majority has not fulfilled its statutory responsibility to produce an EIS. Instead, the majority has opted for the EA, and as a result, the decision to grant the exemption is based, in part, on a faulty and incomplete study.

REVOCATION

The ability to re-impose regulation by revoking the exemption under 49 U.S.C. 10505(d) has definite practical limitations in this proceeding. Even if the exemption were in effect for only a relatively short period of time, there would still be great potential for the occurrence of serious damage. The railroads could absorb shippers' profits, thereby causing some producers to go out of business. Plans for expansion could be canceled or postponed at the very time a demand for increased national coal production is emerging. Also, coal contracts are often long-term commitments, and the parties to many actual or potential coal export contracts or rail transportation agreements could irrevocably change their positions and suffer losses that could not be recouped.

Besides, authorizing an exemption on the basis that we can re-impose regulation is clearly unwise when the potential for serious abuse of market power, the likelihood of decreased U.S. coal exports, and the possibility of grave and irretrievable social, economic, and political damage is so apparent.

LIMITED EXEMPTION

Without question, the exemption proposed should definitely have been denied. In so doing, however, I would have urged the railroads to refile for a partial exemption seeking the establishment of a special zone of rate freedom for export coal movements. Such a zone could have had a fluctuating base and ceiling tied to an index related to the current price of coal.[30] Within the moving zone, the railroads would have been free to set rates without regulatory interference. The Commission could have been relatively certain that rates set within the exempt zone would not involve an abuse of market power because of the relationship established between the index and the zone.

While the proposal and justification of any particular index would have been up to the proponent railroads,[31] the point is that such a zone of rate freedom would have provided the benefits sought from this exemption without its overwhelming detriments. Regulatory burdens would have been reduced, railroads would have had the ability to respond quickly to changing market conditions, and the Commission would have been in a position to fulfill its statutory duty to protect shippers, when necessary, from an abuse of market power.

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[30] The zone's fluctuations could have been based on a percentage relationship to a recognized index, such as the Railroad Freight Price Index, published by the U.S. Department of Labor's Bureau of Labor Statistics (developed by BLS in cooperation with the Commission's Office of Transportation Analysis) or the Department of Labor's Producer Price Index for Coal.

[31] The use of an index for these purposes is not new. Congress adopted a similar approach for the motor carrier zone of rate freedom [49 U.S.C. 10708(d)(3)(B)] which establishes a ratemaking ceiling for the zone based on "the percentage change in the Producers Price Index, as published by the Department of Labor, that has occurred during the one-year period prior to the effective date of the proposed rate."

SUMMARY

This discussion has now come full circle and ends where it began, with the exemption statute itself. 49 U.S.C. 10505 requires that the Commission, using the guidelines established by the Staggers Act, must make two findings. First it must find that the proposal is either of limited scope or will not result in an abuse of market power. Then, the Commission must analyze the expected results of the exemption and find that they compare favorably with the goals of the National Rail Transportation Policy (NRTP).

A simple juxtaposition of the above criteria and the facts and evidence presented in this proceeding shows them to be inalterably incompatible. Certainly rail transportation of export coal is not a matter of "limited scope." No single commodity (other than "coal, all types") comprises more than export coal's traffic share of the railroad industry's annual originating carloads.[32] Export coal involves the shipment of millions of tons of coal worth millions of dollars. No one has made a serious attempt to characterize this exemption as "limited in scope."

More relevant to this proceeding is the alternate standard of whether the exemption will result in an abuse of market power. Based on the record, I cannot find that where undue concentrations of market power already exist due to the near vacuum of any form of domestic competition, it is unnecessary to protect captive shippers of export coal from an abuse of market power. The exemption will not improve the captive shipper's lot but will only remove what little competition and bargaining ability remains. More specifically, the exemption will impair the balance between shipper and carrier interests that Congress so carefully sought to preserve through the reasonable rate and service provisions of the Staggers Act.

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[32] At the 5-digit commodity coal level, the portion of annual carloads represented by export coal is among the highest of all individual commodities. In 1981, for instance, over 93 million tons of coal were moved for export to U.S. ports, in over one million cars.

Turning now to the most important criterion of all, i.e., the National Rail Transportation Policy of 49 U.S.C. 10101a, it must be remembered that this policy has a considerably broader purpose than the improvement of a railroad's profits. The real objective is the maintenance of our rail transportation system for the benefit of all who are dependent upon it. Therefore, such policy mandates a consideration of the whole rail transportation system and the needs of not just the carriers, but also the shipping, receiving, and consuming public. Although the Commission's regulatory reins can and should be loosened or eliminated whenever practicable, caution must be taken to see that reform proceeds in a systematic manner after a careful consideration of all affected interests. Competition and reliance upon the market place are important goals of the NRTP, and to achieve these goals, parties must have relatively equal bargaining positions. Where, as here, one party holds monopoly power, some regulation of that party provides the leverage needed to maintain equilibrium in the marketplace.

The consequences of granting the exemption herein proposed will be a distinct lessening of competition, distortion of the demand for services, unreasonable costs for captive products (thereby imposing an artificial limit on the output of those products), and a serious misallocation of resources. Equally grave are the negative effects the exemption will have on our economic and social well being, on our national security, and on our foreign policy. These results violate all the provisions of 49 U.S.C. 10101a, the object of which is to preserve and improve our rail transportation system so that it may better serve those who use it. Instead of giving the railroads an opportunity to seek a reasonably limited exemption that would have enhanced our transportation system, the majority has, by approving the total exemption, greatly impeded the achievement of the goals set forth in the National Rail Transportation Policy.

As a result, it is regretful but true that only those who yearn for the overly regulatory days of yesteryear will gain any real comfort from the majority's blatant disregard for the policies of Congress and the Administration.

APPENDIX A

HYPOTHETICAL EFFECT OF EASTERN RAILROADS' MARKET POWER OVER DOMESTIC SHIPPERS ON YEAR 2000 STEAM COAL EXPORTS TO EUROPE ASSUMING A CONSTANT PORT PRICE FOR COAL

FOB Pier Price	Mine Mouth Price	Rail Rate	Average Rail Net Revenue	Volume (Millions of Tons)	Total Raile Net Revenuof (Millions Dollars
1980 dollars per ton					
		(1)-(2)	(3)-4.20	$\frac{(2)-34.96}{.03198}$	(5)x(4)
(1)	(2)	(3)	(4)	(5)	(6)
48.00	39.60	8.40	4.20	145.1	609
48.00	39.30*	8.70*	4.50	135.7	611
48.00	39.00*	9.00*	4.80	126.3	606
48.00	38.00	10.00	5.80	95.1	552
48.00	37.00	11.00	6.80	63.8	434
48.00	36.00	12.00	7.80	32.5	254

NOTE: This table by National Economic Research Associates (p. 24 of Dec. 21, 1981 Verified Statement) redone assuming a multiple of 2.5 instead of 5 to compute marginal extraction cost.

*Two mine mouth price/rate levels have been added in order to pin-point the profit-maximizing rate.

VICE CHAIRMAN STERRETT AND COMMISSIONERS ANDRE AND GRADISON commenting:

In view of the significance of this case and the fact that it will be litigated, we believe it is important to emphasize that all statutory requirements and Commission procedures have been met. A brief history may serve to clearly detail the voting and review process that was followed.

On March 3, 1983, a majority of the Commission voted to reject the draft decision which denied the petition for exemption in this proceeding. That decision was prepared and circulated at the direction of the Chairman. In making a determination whether to approve or reject the circulated draft decision, each Commissioner had the benefit of the entire record including information addressing economic, legal, regulatory and environmental issues, and each was free to vote based on his or her consideration of the evidence. However, no final vote could be taken on the exemption petition until a new decision was drafted which effectuated the Commission's determination. Thus, in response to the majority's vote, the staff prepared a new draft decision which approved the exemption petition. The environmental assessment was also expanded to provide greater detail and additional analysis. Our final decision was therefore reached on the basis of the revised draft, the expanded assessment, and the complete underlying record.

The procedures followed in preparing the final decision and environmental assessment were entirely consistent with the statutory requirements and Commission procedures and gave appropriate respect and consideration to the rights and viewpoints of all parties.

APPENDIX A

Our criticism of the NERA study is that it is based on a simple rather than a discfminating monopoly situation as discussed in the text.

Our next major criticism of NERA's study focuses on NERA's calculation of the marginal cost of extracting coal.

In illustrating how the railroads can limit export volume despite highly competitive conditions in the world market, NERA uses an American coal supply function estimated by Martin Zimmerman. According to that function, marginal extraction costs rise $0.01279 per ton every time our reserves are depleted by 1 million tons. In using this function for its purpose, NERA multiplies the figure of $0.01279 by 5 to obtain the change in marginal cost associated with the sale of 1 million tons per year. NERA's grounds, not adequately supported, for this multiple is that the average contract term is for 5 years; every block of 1 million tons commited 5 years depletes reserves by 5 million tons and hence raises marginal cost by 5 times $0.01279. We find, however, that even allowing for an average contract term of 5 years, no multiple is justifed. In fact, NERA itself apparently reverts to use of the $0.01279 figure--without applying any multiple--in generating empirical estimates of benefits and costs using its World Coal Model. Irrespective of whether a multiple is applied, however, the implied elasticity of coal supply is relatively high. Under such conditions, railroads are unlikely to limit export volume unless the international coal market is insufficiently competitive, which NERA argues but which the railroads strongly deny.

Not only was NERA's analysis flawed in its premise, but its calculation of welfare loss was also inaccurate. In its initial statement NERA calculated welfare loss based on projected 1990 export tonnage of 198 million tons. This estimate was clearly unrealistic. In 1981 U.S. coal exports were only 113 million tons. Other independent forecasts come out much lower (e.g., about 145 million tons according to Chase Manhattan). Even these forecasts may be revised downward as the coal glut on the world market persists. NERA also arbitrarily restricted foreign supplies rather than allowing overseas producers to react to market price signals and expand production. This unexplained constraint on foreign production accounts for at least part of NERA's overstatement of American exports in 1990. At the same time NERA refused to allow railroad rates to increase at all over time under regulation, even though, under the Staggers Act, some increase could reasonably be expected. Overprojection of 1990 coal exports and underestimation of railroad rates under regulation resulted in an inflated estimate of welfare loss.

Another flaw in NERA's initial welfare loss calculation was the estimate used for the price elasticity of demand for American imports. NERA adopted the figure of -0.54 from Houthakker and Magie, Income and Price Elasticities in World Trade, 51 Review of Economic and Statistics, 111 (May 1969). One of the railroads' witnesses, Professor Arnold C. Harberger, points out that Houthakker and Magie recalculated this estimate because of econometric deficiencies in the original. The revised estimate is -1.03. The significance of a higher demand elasticity for imports here (demand elasticity being a measure of sensitivity of demand, the quantity demanded, to price change) is that less of a percentage change in the exchange rate is required for the foreign exchange and commodity markets to adjust to the cutback in American coal exports. In table 2 of Harberger's statement, the effects of changing different combinations of export and import elasticities are shown. A change only in the demand elasticity for U.S. imports from -0.54 to -1.03 reduces NERA's projected welfare loss by about one-third.

Witness Harberger also takes exception to the other elasticity measures used by NERA, but the Houthakker and Magie estimate is the only one with respect to which he provides sufficient empirical basis to support a revision. Professor Harberger also disputes that the dollar reduction in proceeds from export coal sales can be equated, as NERA does, with the increase in trade deficit. Harberger is technically right. The drop in coal exports would be expected to free resources for use in other export sections and might dampen import demand, but these indirect effects may be infinitesimal, since they would likely be spread over the whole economy, not just the export/import sector.

Under guise of responding to the Commission's request for further information regarding the export coal industry, NERA sought to rehabilitate its study. Although its submission is clearly a reply to a reply and thus violates our Rules of Practice (Rule 1104.13), no one moved to strike NERA's supplemental statement, and we have considered it in the interest of a more complete record. In its supplemental statement, NERA corrected two of the defficiencies in its earlier presentation. It reduced its U.S. export forecast to 158 million tons and adopted -1.03 as its demand elasticity for American imports. Had it made *only* these changes, it would have strengthened its case. However, at the same time, NERA made *other* changes in its model. It substituted higher rail marginal cost estimates (while, inexplicably, projecting more, rather than less, income for the railroads). It also *reduced* the elasticity of coal demand. Neither of these changes was supported. The reduction in the elasticity is in precisely the opposite direction from what the weight of the evidence in this proceeding plainly shows--that the world coal market is acutely competitive and that demand elasticities are higher (not lower) than originally projected by NERA.

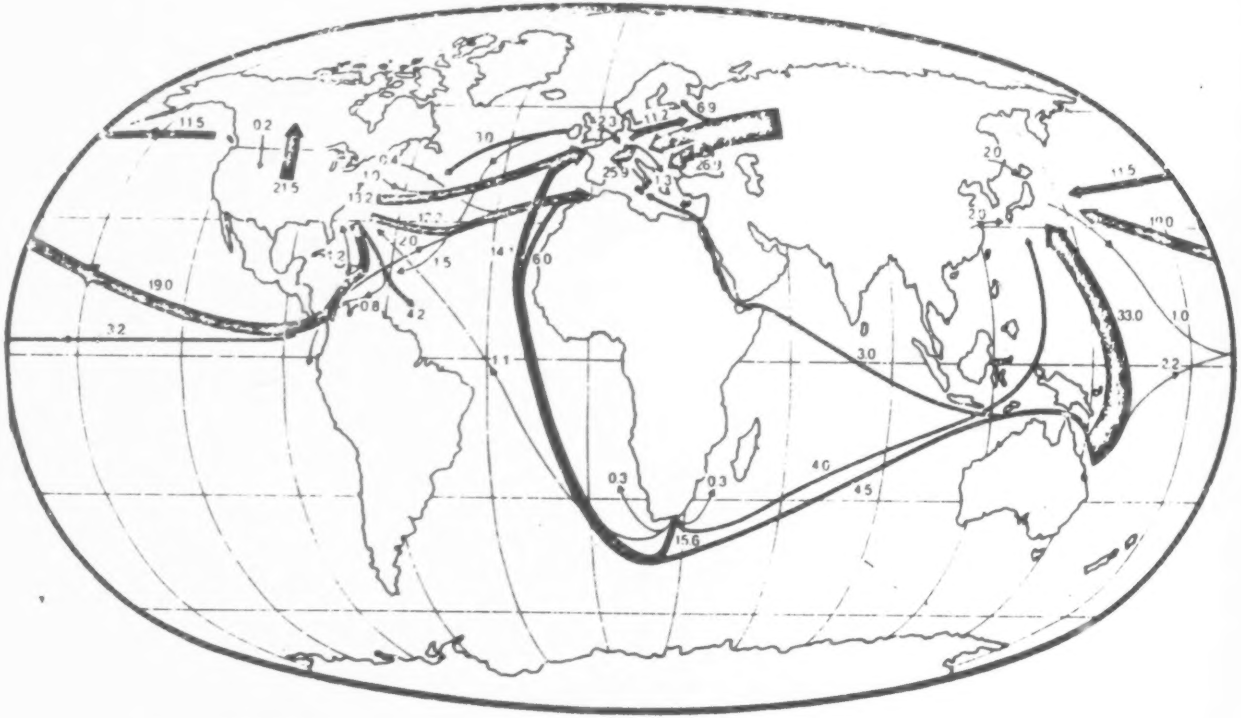
NERA also attempted to modify its model to reflect more intramodal competition than it had originally projected. However, the algebraic formulation of its duopoly model fits more its original hypothetical example of railroads acting as indiscriminant independent monopolists than as discriminating duopolists, which is more likely to be the case following exemption. Not surprisley, NERA's duopoly model produces results little different from its earlier monopoly projection.

NERA does not disclose the limits of the model on which its computations are based. The railroads requested this information, but NERA refused to supply it. NERA's numerical conclusions cannot, therefore, be independently verified.

In sum, NERA's original model was seriously flawed. In correcting its errors, NERA made other mistakes. The fallacy in NERA's premise, as well as its miscalculation of the welfare effect resulting from exemption, preclude our accepting its analysis.

APPENDIX B

INTERNATIONAL COAL FLOW, 1979
(Million Short Tons of Coal Equivalent)


115
02
215
04
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132
172
20
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12
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190
32
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23
112
69
259
13
269
141
60
11
03
03
156
40
45
30
20
20
115
100
330
10
22

Arrows Indicate Origin and Destination
But Not Necessarily Specific Routes

U.S. Department of Energy
Energy Information Administration

ESTIMATED HISTORICAL STEAM COAL FLOWS
(mst)

	U.S.	Australia	South Africa	Western Canada	China	U.S.S.R.	Poland	West Germany/ United Kingdom	Other/ Unidentified	Total Imports
Western Europe										
1979	7.3	4.0	22.3	0.6	-	1.7	20.3	11.9	-	68.1
1980	14.1	4.5	23.0	1.7	-	1.5	18.0	9.8	-	72.6
Japan										
1979	0.1	1.1	0.1	*	0.3	0.2	-	-	-	1.8
1980	1.0	3.9	0.3	0.4	0.7	0.2	-	-	-	6.5
Other Pacific Rim										
1979	-	0.8	-	0.5	?	-	-	-	-	1.3
1980	0.7	1.2	0.3	0.7	0.5	-	-	-	-	3.3
Canada										
1979	11.6	-	-	-	-	-	-	-	-	11.6
1980	10.8	-	-	-	-	-	-	-	-	10.8
Other FMC										
1979	0.4	1.0	-	-	?	-	0.1	-	-	1.5
1980	0.8	1.1	?	?	?	-	?	-	0.7	2.6
Totals a/										
1979	19.4	6.9	20.4	1.1	0.3	1.9	20.4	11.9	-	84.3
1980 b/	27.4	10.7	23.6	2.8	1.2	1.7	18.0	9.8	0.7	95.9

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a/ Excludes Eastern Europe.

b/ Coal trade information from a given importing country is rarely consistent with the information from the corresponding exporting countries. The information may differ with respect to both the quality (steam versus metallurgical) and the quantity of the coals traded. Quality differences may arise when metallurgical grade coals are used as steam coals by the importing country. Quantity differences may arise from reporting inaccuracies or the lag between departures and arrivals. During 1980, export/import information was particularly inconsistent. The figures shown in this table represent ICF estimates. These estimates place emphasis on the data of the exporting country for the total level of coal traded to a given country (steam and metallurgical) and emphasis on the data of the importing country for the proportion of shipments which were consumed as steam coals.

Source: Appalachian Study - Table 4 - 1

ESTIMATED HISTORICAL METALLURGICAL COAL FLOWS
(mst)

	U.S.	Australia	South Africa	Western Canada	China	U.S.S.R.	Poland	West Germany/ Others	Total Imports
Japan									
1979	15.6	27.7	2.8	11.6	0.8	2.6	0.6	0.3	62.0
1980	22.0	28.4	3.1	11.6	1.1	2.1	0.4	-	68.7
Other Pacific Rim									
1979	1.1	4.2	-	0.6	?	-	-	-	5.9+
1980	1.0	3.7	-	0.6	?	-	-	-	5.3+
Western Europe									
1979	15.5	4.7	0.6	1.0	-	1.5	6.1	10.4	39.8
1980	23.7	3.8	0.4	0.1	-	1.3	5.0	9.0	43.3
Canada									
1979	7.6	-	-	-	-	-	-	-	7.6
1980	6.3	-	-	-	-	-	-	-	6.3
Other FME									
1979	4.0	1.7	-	1.0	?	-	2.0	0.6	9.3+
1980	7.0	0.3	-	1.1	?	-	2.0	?	10.4+
Total a/									
1979 b/	43.8	38.3	3.4	14.2	0.8+	4.1	8.7	11.3	124.6
1980 b/	60.0	36.2	3.5	13.4	1.1+	3.4	7.4+	9.0	134.0

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a/ Excludes Eastern Europe.

b/ Coal trade information from a given importing country is rarely consistent with the information from the corresponding exporting countries. The information may differ with respect to both the quality (steam versus metallurgical) and the quantity of the coals traded. Quality differences may arise when metallurgical grade coals are used as steam coals by the importing country. Quantity differences may arise from reporting inaccuracies or the lag between departures and arrivals. During 1980, export/import information was particularly inconsistent. The figures shown in this table represent ICF estimates. These estimates place emphasis on the data of the exporting country for the total level of coal traded to a given country (steam and metallurgical) and emphasis on the data of the importing country for the proportion of shipments which were consumed as steam coals.

Source: Appalachian Study - Table C-17

Metallurgical Coal Production and Exports, 1979-81
(Millions Metric Tons)

Country	Year	Production	Exports	Domestic Demand	Met Coal Reserves (1)
U.S.A.	1981	682.1 (1)	69.2	83.3	147,872
	1980	700.6 (1)	67.2	89.7	
	1979	600.2 (1)	46.0	78.4	
Australia	1981	50.6	39.9	9.4	10,981
	1980	48.7	33.3	8.6	
	1979	48.6	34.1	9.0	
Canada	1981	21.2 (1)	13.7	8.3	77,300
	1980	19.7 (1)	14.2	7.3	
	1979	18.3 (1)	13.0	7.9	
China	1981	200.0	2.0 (e)	NA	200,000
	1980	207.0	1.5 (e)		
	1979	212.0	1.0 (e)		
Germany	1981	95.9	11.2	38.2	17,290
	1980	84.9	12.3	38.8	
	1979	84.3	15.2	34.1	
India	1981	100.0 (e)(1)	0.4 (e)(1)	NA	58,778
	1980	95.9 (1)	0.4 (e)(1)		
	1979	107.3 (1)	0.4 (e)(1)		
Poland	1981	183.4 (e)(1)	3.1 (e)	23.4	11,80
	1980	193.1 (1)	8.3	26.3	
	1979	201.0 (1)	8.4	26.5	
South Africa	1981	9.3	2.9 (e)(2)	7.3	1,00
	1980	7.9	3.1 (e)(2)	7.4	
	1979	7.9	2.3 (e)(2)	7.2	
USSR	1981	185.0 (e)	23.0 (e)	NA	87,00
	1980	189.0 (e)	23.0 (e)		
	1979	189.0 (e)	23.0 (e)		
United Kingdom	1981	127.5 (1)	0.1 (e)	10.8	38,000
	1980	130.1 (1)	0.1	11.6	
	1979	122.4 (1)	0.1	16.1	
Totals	1981	1,806.0	166.6	NA	808,387
	1980	1,790.0	161.4		
	1979	1,858.9	143.6		

(1) Represents anthracite and bituminous coal that can be used in the manufacture of coke, but is not limited to that end use.

(2) Classified as steam coal in South Africa, but used for blending by consumer in the production of coke.

Sources: Zinder Neris, *World Coal Service; Coal Statistics International; World Coal;* U.S. Bureau of Mines Trade Data Reports.

APPENDIX E

COMPARATIVE DELIVERED COSTS OF STEAM COAL EXPORTED TO JAPAN AND EUROPE FROM MAJOR PRODUCING COUNTRIES
(1980 $/million Btu)

Destination/Origin	Mine-Mouth	Inland Transportation	Ocean Transportation	Total Deliveries
To Japan, from:				
U.S. (West Coast Origins)	$1.10	$0.70	$0.45	$2.25
Australia	1.00	0.15	0.45	1.60
South Africa	1.00	0.30	0.65	1.95
Canada	1.35	0.50	0.40	2.25
To Europe, from:				
U.S. (East Coast Origins)	1.65	0.35	0.35	2.35
Australia	1.00	0.15	2.20	2.20
South Africa	1.00	0.30	0.65	1.95

Source: Interagency Coal Export Task Force at 95 and 99.

APPENDIX F

Estimated Coal Exports and Imports 1/
Steam and Met, 1985-90 and 200
(million metric tons)

Estimated Planned Exports	1985	1900	2000
Australia	70	110	190
Canada	34	42	70
Poland	35	40	50
South Africa	36	43	60
United States	115	155	270
Other (including China and Columbia)	20	30	54
Totals	310	395	685

Estimated Imports:	1985	1900	2000
Western Europe	165	215	345
Pacific Rim	120	165	265
Other	10	15	25
Totals	295	395	635

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[1] Excludes trade among Communits Bloc countries. Includes Communist country exports to Free World countries.

Source: Ecklund, Supplemental at 18.

APPENDIX G

HYPOTHETICAL EFFECT OF EASTERN RAILROADS' MARKET POWER OVER DOMESTIC SHIPPERS ON YEAR 2000 STEAM COAL EXPORTS TO EUROPE ASSUMING A CONSTANT PORT PRICE FOR COAL

FOB Pier Price	Mine Mouth Price	Rail Rate	Average Rail Net Revenue	Volume (Millions of Tons)	Total Rail Net Revenue (Millions of Dollars)
1980 dollars per ton					
		(1)-(2)	(3)-4.20	$\frac{(2)-34.96}{.03198}$	(5)x(4)
(1)	(2)	(3)	(4)	(5)	(6)
48.00	39.60	8.40	4.20	145.1	609
48.00	39.30*	8.70*	4.50	135.7	611
48.00	39.00*	9.00*	4.80	126.3	606
48.00	38.00	10.00	5.80	95.1	552
48.00	37.00	11.00	6.80	63.8	434
48.00	36.00	12.00	7.80	32.5	254

NOTE: This table by National Economic Research Associates (p. 24 of Dec. 21, 1981 Verified Statement) redone assuming a multiple of 2.5 instead of 5 to compute marginal extraction cost.

*Two mine mouth price/rate levels have been added in order to pin-point the profit-maximizing rate.

SERVICE DATE
AUG 3 1 1983

EC

INTERSTATE COMMERCE COMMISSION

DECISION

Ex Parte No. 346 (Sub-No. 7)

RAILROAD EXEMPTION - EXPORT COAL

Decided: August 24, 1983

The Coal Exporters Association of the United States, Inc. (CEA) and the National Coal Association (NCA), jointly[1] and the Eastern Coal Transportation Conference[2] (ECTC) have filed petitions requesting the Commission to stay pending judicial review the effective date of its decision to exempt the transportation of export coal from all provisions of subtitle IV of Title 49, United States Code. The Norfolk and Western Railway Company, Chessie System Railroads, and Seaboard System Railroad filed a joint reply.

The Commission's decision (Export Coal) was served June 9, 1983, to become effective September 12, 1983. On June 9, 1983 CEA/NCA and ECTC petitioned the United States Court of Appeals for the District of Columbia Circuit to review the Commission's decision (Nos. 83-1629 and 83-1633).

A stay of an agency action pending judicial review is an extraordinary action that should not be taken except in the most unusual situations. A stay is not a routine action taken simply because an agency action alters the status quo.

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[1] Coastal States Energy Company filed a petition in support.

[2] ECTC's petition to exceed the page limitation is granted.

Rather, a party seeking a stay pending judicial review must establish: (1) that it will suffer irreparable harm absent a stay; (2) that other interested parties will not be substantially harmed by a stay; (3) that it has a substantial likelihood of prevailing on the merits; and (4) that the public interest favors a stay. Washington Metropolitan Area Transit Comm. v. Holiday Tours, 559 F.2d 841, 842-43 (D.C. Cir. 1977). CEA/NCA and ECTC have met none of these criteria, as discussed below. Accordingly, we will not stay the decision.

1. Irreparable Harm Not Shown

We consider irreparable injury to be an indispensable part of the showing necessary to justify a stay. Here, petitioners have completely failed to make the necessary demonstration.

The irreparable harm claimed by CEA/NCA and ECTC takes several forms. First, they predict immediate and substantial rate increases that will assertedly price many coal producers out of the world market. We do not believe that rail carriers would behave in such a patently irrational manner, especially in the current soft coal market. See Export Coal, 20. Indeed, past experience indicates that rail carriers do not even take *authorized* general increases on export coal traffic. Export Coal, 9.

ECTC inaccurately asserts that rail rates on export coal have been "increasing" during the last several months, when they in fact are being reduced by some major carriers, a fact clearly reflective of the effect of the world coal market on rail rates. Similarly, the claim that contracts negotiated while the exemption is under judicial review will bind shippers to long-term high rates is at odds with the railroads' own self-interest and with the sagging demand for coal in the world market in the near future. In short, the current and likely future condition of the world coal market will reduce even further the already minimal potential for any abuse of market power against shippers.

CEA/NCA asserts that our Environmental Assessment (EA) shows a "likelihood" that the exemption will result in increased rates and correlatively decreased export production. This is totally incorrect. The EA is not in any sense of prediction of rail pricing behavior. As we clearly stated (Export Coal, 23) the EA "predicted what would be the effect on production and transportation of U.S. coal for export given certain assumptions about rail price increases for 1985, 1990, and 1995" using recognized econometric models (emphasis added). In other words, the EA merely estimated the effect of assumed rate level changes (both upward and downward) (See Export Coal, 23-24). In no sense did the EA establish the likelihood or magnitude of any increases (or decreases) in export coal rates. (We addressed that issue separately in the principal decision). Hence the EA provides no basis at all for a finding of irreparable harm to shippers in the absence of a stay.

Finally, the petitioners again entirely ignore our ability to revoke the exemption should unanticipated abuses occur that are attributable to the exemption. This revocation power gives us the power to remedy any injury, and thus refutes petitioners' claim of "irreparable" injury.

2. Likelihood of Success on the Merits

A. Scope of Exemption Power

ECTC argues that the exemption power conferred by Section 10505 does not apply to export coal, because coal has been "addressed" by Congress elsewhere in the statute. We find this argument unpersuasive for several reasons. See Export Coal, 13n. 32. First, Section 10505 contains three (and only three) express limitations to the exemption power. These concern carrier liability for claims, intermodal ownership, and employee protection (Section 10505(e) and (g)). Hence, under settled principles of statutory construction, the absence of any other express prohibitions confirms the Commission's usual discretion[3] to decide which areas within its jurisdiction are appropriate for exemption.

If the mere mention of particular commodities or services elsewhere in the statute excluded those matters a priori from possible exemption, as urged by ECTC, the TOFC/COFC exemption affirmed in the ATA decision would not have been possible. See, e.g., 49 U.S.C. 10922(k), 10923(e), 10705a(k)(1). Obviously, that is not the case. Rather, Section 10505 "charge[s] [the Commission] with the responsibility of actively pursuing exemptions for transportation and service

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[3] See American Trucking Ass'ns v. ICC, 656 F.2d 1115, 1125-26 (5th Cir. 1981).

. . ." H. Rep. No. 1035, 96th Cong. 2d Sess. 60 (1980) (emphasis added). Indeed, Congress apparently "expect[s] that as many as possible of the Commission's restrictions on changes in prices and services of rail carriers will be removed. . . ." H. Conf. Rep. No. 1430, 96th Cong. 2d Sess. 105 (1980) (emphasis added). See also Export Coal at 13-14.

Similarly, CEA/NCA argues that the exemption exceeds the Commission's authority under Section 10505 because it upsets a "balance" of regulatory restraint and pricing flexibility struck in the Staggers Act itself. Congress did not intend that all boundaries between regulated and non-regulated rail activity in the statute be preserved permanently. If that were true, the exemption power would not have been granted to this agency. Rather, the Staggers Act identified particular areas where reduced regulation was appropriate, e.g., the jurisdictional revenue-to-cost threshold for rail rates, 49 U.S.C. 10701a, 10707a. But these statutory efforts to reduce regulatory burdens are merely the starting point for further exemption under Section 10505. As explained in the Conference Report on the Staggers Act (H. Conf. Rep. No. 1430, supra, at 105):

> The policy underlying this provision [Section 10505] is that, while Congress has been able to identify broad areas of Commerce where reduced regulation is clearly warranted, the Commission is more capable through the administrative process of examining specific regulatory provisions and practices not yet addressed by Congress to determine where they can be deregulated consistent with the policies of Congress.

Our efforts in this case to go beyond the statutorily deregulated areas are thus entirely consistent with the legislative design.

B. Consistency With National Transportation Policy

ECTC and CEA/NCA complain that our earlier decision to grant the exemption "omits" any discussion or analysis of various elements of the national rail transportation policy, 49 U.S.C. 10101a. We in fact devoted a considerable portion of our earlier discussion to Section 10101a issues. See Export Coal 14-20. The petitions for stay for the most part merely restate the arguments we considered and rejected in the principal decision. We therefore will not repeat our entire analysis here.

ECTC urges that the exemption violates Section 10101a(14) by frustrating the goal of "availability of accurate cost information." As the rail carriers point out in reply, most of the recordkeeping done by rail carriers is not differentiated on the basis of export or non-export transactions. Moreover, Section 10101a(14) addresses cost data "in regulatory proceedings." Exemptions necessarily eliminate regulation and the correlative proceedings. Section 10101a(14) therefore cannot be a categorical bar to exemption where otherwise appropriate.4/

4/ As the Fifth Circuit observed in ATA, supra, "the fact that the exemption has a limiting effect on the scope of . . . other provisions of the Interstate Commerce Act does not demonstrate that Congress did not mean what it said in Sections 10505(a) and (f)." 656 F.2d at 1122.

ECTC also expresses concern with possible "non-compensatory" traffic and the Commission's supposed inability to monitor the honesty and efficiency of railroad management, both of which concerns are expressed in Section 10101a(10). Our earlier decision explained at length that the economic realities of the world coal market constrain rail rate increases and hence provide an inherent sanction against inefficiency. Export Coal, 20-23. We also noted (id. at 15) that below-cost pricing by rail carriers was not likely to occur for economically similar reasons. Hence the claim of potential non-compensatory traffic being handled on a large scale must be rejected for the same reasons.

C. Abuse of Market Power

CEA/NCA argues that the world market constraint on coal (and derivatively rail) pricing is "irrelevant" to the need for protection of shippers. This amounts to mere restated disagreement with the result we reached in our earlier decision. ECTC also urges that the world market price "cap" will not protect shippers or ensure a "reasonable" division of profits between coal producers and rail carriers.

As explained in our earlier decision, the long-run common interest of shippers and carriers is to bring into the world market as much American coal as the market will absorb (Export Coal 20-22). It is precisely because of this commonality of interests that we believe the market to be an adequate constraint on export rates without further regulatory intervention. We recognize, although the petitioning parties apparently do not, that coal exports are not a "zero-sum game" between the carriers and the shippers. Rather, the efficient and profitable operation of both businesses are mutually intertwined. Our exemption decision is not intended to favor one group at the expense of another, but to free the entire export coal industry from an unnecessary regulatory burden. We fully expect our action ultimately to benefit coal producers and carriers alike.

ECTC's remaining arguments on the need for shipper protection assume an entirely hypothetical "match" of individual mines against rail carriers in rate negotiations. As explained in our earlier order (Export Coal, 20-22), the presence of sizable transshippers possessing substantial bargaining leverage assures substantial parity between the parties in negotiating rate contracts.

ECTC argues that the antitrust laws are an inadequate remedy for any future market power abuse, because they apply only retrospectively and do not restrain pricing practices of "natural monopolists." We have explained previously that monopoly pricing and abuse of market power are not likely to occur in the economic environment of the export coal market because of economic market forces. See Export Coal, 20-23. But even if our estimate should prove wrong in some respect, the antitrust laws are not the only remedy. We have already stated (Export Coal 23), and we reaffirm here, that this agency stands ready to limit or revoke the export-coal exemption if, contrary to our expectations, proven abuses do materialize. See 49 U.S.C. 10505(d).

On a more fundamental level, however, reliance upon antitrust remedies in an exempted area of our jurisdiction is a basic part of the Congressional design embodied in Section 10505. As the legislative history confirms (H. Conf. Rep. No. 1430, supra, at 105) (emphasis added):

> The conferees anticipate that through the exemption process the Commission will eventually reduce its exercise of authority to instances where regulation is necessary to protect against abuses of market power where other federal remedies are inadequate for this purpose.

We consider it evident that the antitrust laws are among the most prominent "other federal remedies." Congress also has referred to the residual protection afforded by antitrust laws in other instances where rail matters were removed from regulatory supervision by statute. See, e.g., H. Conf. Rep. No. 1430, supra, at 101 ("existing Federal antitrust laws apply" to contracts generally removed from Commission rate regulation under 49 U.S.C. 10713).

As to the supposedly ineffectual role of the antitrust laws in cases of "natural" monopoly, we do not believe ECTC has any real cause for concern. First, as an economic matter, we have rested our exemption decision on the ability of the world market, in combination with the economic self-interest of rail carriers and export coal shippers, to preclude true monopoly pricing. But even if a monopoly did arise (and ignoring the revocation option discussed earlier), the antitrust laws may well come into play.

ECTC argues that the antitrust laws are not an effective constraint because they do not apply to the pricing practices of a "single, natural monopolist" such as a coal-hauling railroad assertedly is. We do not accept the premise that any railroad has achieved monopoly power or is capable or likely to engage in monopolistic pricing on coal export movements. Indeed, our entire economic analysis of the export-coal market points in the opposite direction.

Second, ECTC is incorrect in asserting that the antitrust laws do not apply to unilateral actions of "natural" monopolists. Section 2 of the Sherman Act (15 U.S.C. 2) addresses both monopolization and attempts to monopolize. See United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966); United States v. Aluminum Co. of America, 148 F.2d 416, 431-43 (2d Cir. 1945). Certainly some anticompetitive conduct is a prerequisite to proof of monopolization. See Standard Oil of New Jersey v. United States, 221 U.S. 1 (1911), Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 273-75 (2d Cir. 1979), cert. denied, 449 U.S. 912 (1980). But an attempt to monopolize can be shown if there is a specific intent to monopolize and sufficient market power to create a dangerous probability of successful monopolization. Alcoa, supra; Swift & Co. v. United States, 196 U.S. 375, 396 (1902). In either type of case, however, individual conduct (not merely collective activity) is within the reach of the Sherman Act. Hence we see no basis for rejecting a priori the availability of antitrust remedies in curbing potential abusive conduct.

D. Exemption from Non-Rate Provisions of the Statute

ECTC and CEA/NCA allege that the Commission improperly extended the coverage of the export coal exemption to all provisions of Subtitle IV of Title 49, United States Code, in contrast to the railroads' amended petition seeking exemption only from Sections 10701 through 10712. Assertedly, these non-rate aspects of the exemption were ordered without evidentiary support, and without explanation. This is incorrect.

Our notice of proposed rulemaking sought comment on the possible exemption of export coal transportation from some or all of Commission regulation. 46 Fed. Reg. 44529 (Sept. 4, 1981). See also Export Coal 1. In proposing an exemption (or any rule, for that matter) we are not limited by the scope of a party's request for a rulemaking. See 49 U.S.C. 10321, 10326.[5] Here we went beyond the (amended) request of the petitioning rail carriers. However, all parties had full notice that complete exemption was an option being considered. Compare 5 U.S.C. 553.

Although the principal focus of the comments was ratemaking, CEA/NCA and ECTC are incorrect in asserting that there was no record support for extending the exemption to include all provisions of the statute.[6] Moreover, the same economic restraints that will curb railroad pricing will also tend to curb service abuses.

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[5] The Staggers Act eliminated the requirement that we conduct a "proceeding" before ordering an exemption. Improvement of TOFC/COFC Regulation, 364 I.C.C. 731, 736-37 (1981). Here, however, we have given all interested parties a full and fair opportunity for prior comment.

We explained (Export Coal, 14-20) how complete exemption of export coal transportation would promote various goals stated in the national rail transportation policy, 49 U.S.C. 10101a. Obviously, many of those goals encompass areas far beyond rate matters. Thus, we did not limit our analysis to the rate sections of the statute as claimed by the petitioning parties.

We also explained how the exemption would improve the quality of rail service in two complementary ways. The tailoring of service to specific shippers' needs via contracts (rather than generally applicable tariff rates) should benefit the shippers. In addition, the use of long-term contracts should allow rail carriers better access to capital markets using the "collateral" of their contracts, thus fostering increased capital expenditures on loading facilities and equipment and a consequent improvement in the quality of service offered. As noted in our earlier decision, all parties benefit from an environment in which "certainty of future business [is] sufficient to justify new investment." Export Coal, 16.

As to the specific statutory provisions cited by CEA/NCA and ECTC, we find that these offer no basis for limiting the exemption before it has even been tried. Exempting export coal from the

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[6] For example, improvements in quality of rail service as a result of the exemption were discussed. Petition for Exemption, V.S. R.J. Barber, pp. 19-21; Railroad Reply Comments Vol. I, V.S. Claytor; V.S. Collinson, p. 7; DOT Comment, p. 3; N&W Response, p. 21, V.S. Gobrecht, p. 14; DOT Opening Statement, pp. 8, 13-14, App. pp. 16-17.

"commodities clause" (49 U.S.C. 10746) assertedly will allow rail carriers to somehow prefer their own coal over that of non-affiliated producers. The rail carriers, however, point out in reply (with supporting affidavits) that the coal supposedly controlled by the carriers exists in the form of mineral rights on railroad-owned land, usually leased for extraction to third parties on a long-term basis. Hence the rail carriers do not now have the type of vertically integrated corporate structure needed to make any such hypothetical preference feasible. Certainly at minimum the existence of long-term leases would preclude any substantial preference during the period needed for judicial review, even if these leasing arrangements ultimately are subject to alteration.

As to the coal-car distribution provision, 49 U.S.C. 11126, we see no substantial risk of abuse. The equipment for domestic and export coal movements is largely interchangeable, and our supervisory power over domestic coal car distribution is not affected by this exemption. Again, we believe that the carriers' self-interest and the reasons why carriers will not be able to engage in rate abuses will assure reasonable levels of service, and the quality of service should benefit from the increased ability of railroads to attract additional capital via increased reliance upon negotiated rates.

The "war emergencies" provision (49 U.S.C. 11128) is also of minimal concern. It becomes applicable only "during time of war or threatened war" and also requires a presidential certification or request to expedite or prefer military traffic. CEA/NCA and ECTC offer no reason why our response to any such emergency request from the President could not include an order temporarily revoking the exemption to the extent necessary.

The statutory codification of railroads' common carrier obligation (49 U.S.C. 11101(a)) is included within the coverage of the exemption. CEA/NCA and ECTC express concern that, once exempt from the section, the railroads will simply refuse to serve shippers. This would, however, be contrary to the carriers' strong economic incentive to move as much coal traffic as possible. We also reiterate our readiness to revoke or limit the exemption if actual experience (not mere speculation) indicates that abuses are likely.

Similarly, the petitioning parties argue that exempting export coal movements from the contract-rate tariff and complaint structure of 49 U.S.C. 10713 will harm shippers by permitting railroads to lock them into undesirable contracts that cannot be "undone" if the exemption is reversed on judicial review. This claim is unpersuasive for several reasons. First, as noted in our earlier decision, there appears to be substantial equality of bargaining power between shippers and carriers in the export coal market. See Export Coal, 21-22. Second, the market for export coal is presently soft, in part because coal prices and demand are reflecting the world price of oil. See Export Coal, 21.7/ Events since our decision confirm that

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7/ The recent General Accounting Office study, Prospects for Long-Term U.S. Steam Coal Exports to European and Pacific Rim Markets (Aug. 4, 1983), confirms that "continued low oil prices will undoubtedly slow oil-to-coal conversion and depress coal demand growth." GAO Study, 11.

rail rates on export coal are being kept at existing levels or even reduced. This confirms the crucial role of the world market price "cap." It also shows that for the period needed to complete judicial review of the exemption decision, the carriers are likely to be severely constrained even as to negotiated rate levels by the state of the world market. Hence the one-sided contracts hypothesized by ECTC and CEA/NCA are most unlikely. Finally, the railroads apparently concede in their reply to the stay petitions that our Section 10505(d) revocation power could reach contracts negotiated during a later-revoked exemption.[8]

We believe that the contentions of CEA/NCA and ECTC regarding the non-rate portions of the statute affected by the exemption reflect a fundamental misunderstanding of the exemption process. In any rulemaking, of course, we are engaged in a quasi-legislative activity. An exemption, moreover, is if anything closer to "delegated legislation" than most other rulemakings of this agency. Usually, our rules are discretionary efforts to "carry out" specific provisions of the statute under Section 10321(a). We issue such rules to fill various interstices in the statute. But in considering exemptions, we are performing a mandatory duty to eliminate regulation of rail transportation wherever the statutory criteria are met. Any exemption inherently involves an element of experimentation. As the court put it in ATA, supra, 656 F.2d at 1127:

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[8] We also see no reason to doubt that force majeure clauses addressing the future status of any exemption are an option available to all draftsmen of export-coal rate contracts.

> That Congress recognized that the effects of a particular exemption decision could not be predicted with certainty -- and thus that the Commission would be exercising its exemption authority in the face of uncertainty as to the effect of on exemption -- is apparent both from the controlling statute and legislative history.

Hence, all that this agency can do is to assure that "all relevant factors were considered and . . . articulat[e] a rational connection between the facts as it finds them and the conclusion it premises on those facts." *Id.* We believe that we have done so here, and that the stay petitions raise no substantial issue as to the rationality of the exemption decision.

Before turning to the other stay criteria, we address briefly an additional attack on the lawfulness of the exemption made by ECTC in its recently filed petition for judicial stay[9] (but *not* in its pleadings before this agency).[10] ECTC alleges that the export coal exemption "violates" the Merchant Marine Act of 1920, 46 U.S.C. 876(c)(2). That statute requires that a "rule or regulation. . . which affects shipping in the foreign trade" be submitted to and approved by the Federal Maritime Commission (FMC). ECTC claims that our exemption decision fails to comply with this requirement.

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[9] *Eastern Coal Transportation Conference* v. *USA and ICC*, U.S.C.A., D.C. Cir., No. 83-1633 (Motion for Stay, Aug. 12, 1983, pp. 67-70).

[10] Compare *United States* v. *L.A. Tucker Truck Lines*, 344 U.S. 33 (1952). Accord, *Brotherhood of Ry. Employees* v. *St. Louis Southwestern Ry.*, 676 F.2d 132, 136 (5th Cir. 1982); *Brotherhood of R.R. Trainmen* v. *Chicago, M. St. P. & P.R.R.*, 380 F.2d 605, 608-09 (D.C. Cir. 1967), *cert. denied*, 389 U.S. 928 (1967); *Litton Industries, Inc.* v. *FTC*, 676 F.2d 364, 369 (9th Cir. 1982); *NLRB* v. *GAIU Local 13-B*, 682 F.2d 304, 312 (2d Cir. 1982).

We do not believe that the export coal exemption "affects shipping in the foreign trade" within the meaning of the Merchant Marine Act. Accordingly, it does not require FMC review. See Improvement of TOFC/COFC Regulation, supra, 364 I.C.C. at 733. As in the TOFC/COFC case, our exemption does not impair FMC's authority over port-to-port ocean carrier rates. ECTC offers no authority for including a rail exemption which ends at the water's edge within the Merchant Marine Act.[11]

Even if the exemption arguably falls within the scope of the Act, we believe that FMC's complete silence must be taken as implicit recognition that the statute does not apply or, if applicable, that FMC has no objection to the exemption. Almost two years have elapsed since the notice of the proposed exemption was published in the Federal Register. Yet FMC filed no comment, much less any objection. Compare ATA,, supra, 656 F.2d at 1124. Moreover, we announced our tentative intention to grant the exemption in March, 1983, and after issuing a final decision in June, allowed an additional three months before its effective date. Yet FMC has not questioned the effect or propriety of the exemption in any communication to this agency. Compare TOFC/COFC, supra, 364 I.C.C. at 737; ATA, supra, 656 F.2d at 1124-25. In addition, although petitions for judicial review have been on file in the court since the day we issued our decision, FMC has not appeared in those proceedings or offered any objection to the scheduled effectiveness of the export coal exemption. Hence we do not believe that ECTC's claim based on the Merchant Marine Act raises any substantial doubt as to the lawfulness of the exemption.

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[11] The court in ATA, supra, expressly refused to decide whether the TOFC/COFC exemption as applied to ex-water traffic fell within the scope of the Act. 656 F.2d at 1124.

3. Harm to Other Parties Likely

We devoted considerable attention to the beneficial effects of the exemption upon the rate contracting environment and correlative improved access of rail carriers to capital markets. Export Coal, 16. Many other benefits, including improvements in service and intermodal coordination are also likely. Export Coal, 16-17.

Against our best judgment that carriers (and the public) will benefit from prompt implementation of the exemption, CEA/NCA offers only the claim that, since the carriers do not now have the benefit of the exemption, they would not be harmed by a stay. If that illogic were correct, then every exemption (or any other change in the status quo) would have to be delayed until judicial review had been completed.

ECTC argues that, because the exemption is not motivated by an "emergency," other parties will not be harmed by a stay. This, of course, does not follow. Moreover, it is not the standard for a stay pending review. We do believe that ECTC's assertion regarding the non-urgency of the exemption bears further comment. Specifically, we emphatically reject ECTC's portrayal of the September 12, 1983 effective date as an indication that we allowed a "full six months" to elapse after our decision, because the exemption was of no particular importance or urgency. In its petition, ECTC inaccurately states that the exemption "decision" took place in early March. In fact, no legally binding decision was made until the final vote on May 26. The United States Court of Appeals for the District of Columbia Circuit has twice confirmed this by dismissing petitions for judicial review (including ECTC's) filed before the actual decision was served. Thus, the correct period between service of our exemption decision and its effective date is in fact barely three months, or about half that asserted by ECTC. Even that delay does not reflect any misgivings over the exemption or a belief that its prompt implementation is not necessary. Rather, we merely allowed a pre-effectiveness period comparable to that for other major rulemakings.

4. Stay Contrary to the Public Interest

ECTC and CEA/NCA contend that the public interest favors a stay because some federal agencies and members of Congress commented in opposition to the exemption. Despite the fact that various arms of the federal government may hold views different from ours, their opposition to a particular course of action is not the final word on the public interest. Moreover, CEA/NCA and ECTC fail to mention that another federal agency, the Department of Transportation, supported the exemption.[12] See Export Coal, 11. While we have seriously considered and respect the views of other federal agencies and legislators, the task of deciding whether to order an exemption is ultimately the responsibility of this Commission. That task is not merely an option, but a duty, for Section 10505 commands that we

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[12] Another agency, the General Accounting Office, in its recent study of the world steam coal market, discussed the proposed exemption, but took no position on the merits of the exemption. See GAO Study, pp. 29-33.

"shall" exempt particular rail transportation matters where the statutory criteria are met, as they are here. See American Trucking Ass'ns, Inc. v. ICC, 656 F.2d 1115, 1119 (5th Cir. 1981).

It is ordered:

The petitions for stay pending judicial review are denied. The exemption will take effect as scheduled on September 12, 1983.

By the Commission, Chairman Taylor, Vice Chairman Sterrett, Commissioners Andre and Gradison. Chairman Taylor dissented with a separate expression.

Agatha L. Mergenovich
Secretary

(SEAL)

CHAIRMAN TAYLOR, dissenting:

In my dissent to the May 26, 1983, decision which approved the exemption for export coal, I pointed out many of the fallacies and inaccuracies in the majority's rationale. Their belated attempt here, in response to a stay request, to buttress and paper over the fatally flawed decision on the merits only emphasizes their irresponsible election to disregard the law and evidence of record in order to achieve their desired result by resort to some carefully contrived rhetoric.[1] However, no artful use of words and phrases can change the bottom line, which is that no persuasive evidence was presented to justify a grant of the exemption for export coal.

Petitioners have more than met their burden for a stay pending judicial review. They have demonstrated not only the multiple substantive legal and procedural deficiencies of the May 26th decision, but they have also shown the severe and far-reaching damage which will occur should this decision take effect. There is a substantial likelihood that petitioners will prevail on the merits in court. Without question, the fact that the decision is arbitrary, capricious, an abuse of discretion, and not in accordance with the law, has been demonstrated repeatedly by the numerous documents placed in evidence by protestants to this exemption, by the reports generated by our own staff, and by the stay requests and court briefs of petitioners. Therefore, to avoid repetition, my remarks here will be limited to a discussion of the salient points germane to the stay request.

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[1] This somewhat cavalier attitude is documented by the fact that on March 3, 1983, the majority voted to exempt all export coal, including that moving through Canada and Mexico. Subsequently, this expansion was retracted for lack of notice and evidence in support of extending the exemption beyond U.S. ports.

IRREPARABLE HARM HAS BEEN SHOWN

Petitioners have made a strong showing that the exemption, if allowed to take effect, will seriously injure the interests of coal producers, both with respect to their business posture and their ability to obtain continued rail service.

A number of specific results are authorized by the exemption. For example, insofar as railroads are concerned, they (1) would be under no obligation to provide service to shippers along their lines, (2) could set export rail rates from mine to port, (3) would be able to prefer coal shipments originating from railroad-owned mines to railroad-owned port facilities, and (4) could require captive coal shippers to choose between entering long-term contracts or face either rapidly rising rates or discontinued service.

Although the majority airily dismisses these ramifications, there are many cases, as will be discussed more thoroughly infra, when it would be in a carrier's best interests to exploit the exemption to the fullest possible extent.

While the railroads have supplied no economic calculation of how the volume of export coal will be affected by their actions under deregulation, the majority of the comments and the Commission's own Environmental Assessment (E.A.)[2] support the conclusion that the exemption and the concomitant rate increases will result in a decline in demand for export coal.[3]

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[2] If, as the majority seems to suggest, the EA's assumptions regarding increased rates and decreased volumes are not relevant, one must then ask what value it has and why the majority has relied upon it to fulfill the NEPA requirements?

Purchasers in countries such as Japan, Spain, Brazil, Italy, the Netherlands, and Ireland, who currently rely on U.S. coal as a reliable source in an unstable world market, have all expressed the concern that price increases and a lack of stability in the delivered price will reduce the attractiveness of U.S. coal as a reliable source and as an alternative for foreign coal, OPEC oil, and Soviet gas.[4]

Significantly too, these foreign markets, once lost, cannot be easily regained. One does not move easily in and out of the export coal market. The Commission's ability to revoke the exemption provides only after-the-fact assurances. In order to justify a revocation, the harm would have to occur, notice would have to be given, comments would have to be received, and positive action would have to be taken by the Commission. By the time this chain of events takes place, irreparable damage will have been done, so revocation is, at best, an imagined remedy.

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[3] See generally the recent report by the Energy Information Administration, U.S. Dept. of Energy, Railroad Deregulation: Impact on Coal, issued August 1983 (EIA Study). This study concludes that the most likely trend, given the exemption, is increased rates and decreased production.

[4] The United States Department of Commerce, in a statement supporting CEA/NCA's petition to reopen the record in this proceeding, noted that the United States' share of the export market is already beginning to decline, "due in part... to the perception on the part of foreign purchasers that rates for the rail transportation of U.S export coal will not likely be subject to any form of regulatory constraint in the future."

PETITIONERS ARE LIKELY TO SUCCEED ON THE MERITS

The Staggers Act is a comprehensive document which embodies Congressional concern for the well-being of both carriers and shippers. As such, its legislative history and various provisions must be considered as a whole. To evaluate each part in a vacuum, as the majority proposes, ignores the very essence of the Act, which is to remove regulatory restraints whenever adequate competition is present, but to continue regulation when the marketplace is unable to protect captive shippers. The legislative history of the Staggers Act is replete with expressions of Congressional concern for captive shippers in general and captive coal shippers in particular.[5]

Thus, the Staggers Act was intended to stimulate competition, not stifle it at the expense of captive shippers, and the exemption provision, 49 U.S.C. 10505, is an integral part of that Act. Before approving an exemption under Section 10505, the Commission must find that regulation is not necessary to carry out the national rail transportation policy and that the exemption proposed is either of limited scope or is not likely to result in an abuse of market power.

In reaching to approve the export coal exemption, the majority, of necessity, was obliged to ignore those aspects of the evidence which did not support their desired result. Many of the elements of the national transportation policy mitigated against the exemption and so they were ignored. The potential for abuse of market power was dismissed with the generalization that it is in the "interest of shippers and carriers...to bring into the world market as much American coal as the market will absorb." But consider that export coal has neither intra nor intermodal competition; that it moves almost entirely by rail, generally with access to only one originating railroad; and that there is little, if any, geographic or product competition. Moreover, any competition in the world market serves only as a price cap which provides no control over the division of profits below that point.

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[5] See, e.g., S.Rep.No. 470, 96th Cong., 1st Sess. 7-8, 17, 43, (1979); H.Rep. No. 1430, 96th Cong. 2nd Sess. 80 (1980).

Therefore, despite all the convolutions of logic engaged in by the majority, the question is: Will the railroads, freed from any regulatory constraint, act benevolently or in their own best interests? Without competition or the bargaining chips afforded shippers by the Staggers Act protections, there is little incentive for a carrier to negotiate with a shipper. Contrary to the meaningless assurances of the majority that it will be in the best interests of the railroads to negotiate, the truth is that carriers will logically have the financial incentive to present an export coal shipper with a rate and service offering that best suits the railroad.

In fact, in a softening world market with declining volumes, it can be expected that any price decreases to meet the world price will come at the expense of the producer and not the carrier. Further, due to economies of scale, higher profits made at the expense of the producer will more than compensate a railroad for any decreases in the amount of export tonnage.[6]

But, assuming arguendo, that a railroad *would* seek to carry all the coal traffic it can handle, whose coal will be transported to satisfy the soft world market? (And here is where the relationship between the rate and nonrate portions of the exemption comes into play.) Without the common carrier obligation of 49 U.S.C. 11101(a), or the car hire/car service requirements of 49 U.S.C. 11126, will service be provided to the large shipper that guarantees unit trains or to the small mine that ships only a few cars? Without the commodities clause in 49 U.S.C. 10746, or the statutory protections against discriminatory rates, will the better transportation rate go to mines located on railroad-owned lands[7] for long haul to railroad-owned port facilities, or to other coal producers competing in the export market? What bargaining power does a coal producer have when offered either a long-term contract or no service at all? And lastly, what is the alleged "benefit" that the majority believes coal producers will derive from this exemption?

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[6] See also E/A Study, *supra* n. 3, and Appendix A, in my dissent to the May 26th decision, at 47.

[7] In many cases, the "third-parties" holding the long-term leases are actually rail affiliates.

These questions are but a few of the many that could be posed to illustrate the majority's deficient analysis and their failure to adequately consider the statutory balancing of interests called for by the Staggers Act.

Lastly, the majority's election to by-pass the preparation of an Environmental Impact Statement constitutes an incurable omission, as pointed out in my dissent to the May 26th decision. The hastily assembled EA is not only an inadequate substitute for the statutorily required EIS, but it does not even provide sufficient EA information. For instance, the basis for the EA's results is its composite case that rates will most likely increase and exports decrease as a result of the exemption.[8] But the majority now states that this is merely a prediction and provides no basis for a finding that coal shippers will be harmed. However, if the EA's entire analysis is merely a prediction which the majority declines to accept, then the EA must also be inadequate to satisfy the requirements of the National Environmental Policy Act, 49 U.S.C. 4332(2)(C).

THE STAY WILL NOT HARM OTHER INTERESTED PARTIES

There is nothing in the record or the pleadings to indicate that the railroads would be injured by a stay. It is especially telling that only two railroads, the N&W and the Chessie, have objected to the stay, and their principal argument is that a stay would impede their ability to contract for export coal shipments. However, hundreds of coal contracts have been filed with the Commission and no railroad has been able to document even a single occasion where a contract has been lost because of regulation. Accordingly, there is no reason to believe that a stay would deprive the railroads of their ability to contract for export coal shipments.

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[8] A position supported by the EIA Study, *supra* n. 3.

Furthermore, railroads already exercise a substantial measure of ratemaking flexibility. Both the market dominance jurisdictional threshold and the Commission's recent decision proposing maximum coal rate guidelines, Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, Nationwide (not printed), decided February 8, 1983, provide the railroads with broad pricing discretion. Therefore, the carriers will not be harmed by a stay which merely maintains the status quo pending judicial review.

THE STAY WOULD FURTHER THE PUBLIC INTEREST

There is considerable evidence that the market for export coal is softening. The filings of the Departments of State and Commerce, the U.S. Trade Representative, and foreign buyers of U.S. coal, all show how sensitive the market is to the pricing of its component elements (production, transportation-to-port, shipping, etc.). It is important to our national security that our allies have a secure, economic, and competitively priced alternative to unpredictable supplies of imported energy. The exemption, by shifting profit from producer to carrier, will exacerbate the decline in coal exports, thereby undercutting a key element of U.S. international energy policy, and will substantially weaken, if not eliminate, a potentially important factor in restoring to this nation a favorable balance of trade.

Additionally, the E.A. and the testimony of the three Senators appearing at the oral argument on June 16, 1982, demonstrate the relationship between regional coal industry employment and the export market. A diminishing demand for export coal translates directly into reduced production in coal supply regions. The Commission's E.A. composite case shows that a complete loss of all export production in four states, and substantial productivity reductions in others, will be a direct result of the declining demand for export coal brought about by increased transportation rates. These losses will have a severe adverse impact upon the nation's balance of trade, upon primary and secondary employment levels, upon local and regional tax bases, and upon the communities and families that depend on mines which are forced to decrease or stop production.[9]

The public interest, therefore, lies in staying the decision until a Court of Appeals has thoroughly reviewed the many serious legal issues which have been raised with regard to the export coal exemption.

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[9] As discussed infra, any possible revocation would only occur after the harms had occured.

SUMMARY

The majority's self-styled "experiment" will not promote the national transportation policy, nor is it of limited scope, and it will most certainly result in undue concentrations of market power. While the railroads will undoubtedly have increased opportunities for financial gain as a result of the exemption, this gain will only be achieved by a distinct lessening of competition, a distortion of the demand for services, unreasonable costs for captive coal shippers, and a serious misallocation of resources, together with negative effects on our economic and social well being, on our national security, and on our foreign policy. Consequently, our "mandatory duty" was to deny the export coal exemption. As a recent Court of Appeals decision noted, the transition envisioned by Congress under the Staggers Act should be a "measured passage from the old regime to the new" and not "a hasty rout."[10] Petitioners' right to a stay has been unjustly denied.

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[10] Ford Motor Co. v. Interstate Commerce Commission and United States of America, No. 82-1630, slip op. at 3 (D.C. Cir. Aug. 9, 1983).

Senator **Warner**. I just want to ask one question and hope when your other colleagues testify they can address the question, and that would be your definition of revenue adequacy.

Chairman **Taylor**. We have defined revenue adequacy as being equated with the current cost of capital. That is the way we have looked at it. I might say that that decision has been reviewed by the court, too, Mr. Chairman, and withstood judicial scrutiny.

The definition was changed and adopted just shortly before I came to the Commission. It was done in March 1981, and it has been tested in court. We have had a lot of litigation about ICC decisions.

Senator **Warner**. We have got to move right alone here. Are there any U.S. railroads currently revenue adequate by your standard?

Chairman **Taylor**. We have not found any that are currently revenue adequate, Mr. Chairman.

Senator **Warner**. The next question would be given that, how do you explain the rather substantial proliferation of acquisitions—Burlington Northern, El Paso—costing over $600 million; the CSX purchase of Texas Gas costing over $1 billion; Norfolk & Western, Southern, $900 million in the bank awaiting use for acquisition purposes? How do you address these facts in light of your statement that you have found no railroad to be revenue adequate?

Chairman **Taylor**. Well, I think the first thing you have to do is distinguish between the railroad operations and the other entities they are endeavoring to acquire, because in most cases those are being acquired by the parent companies.

Senator **Warner**. Through the holding company structure?

Chairman **Taylor**. Not by the railroads themselves. Our concern is with the railroads themselves. I have brought some recent financial data on the railroads. Everybody has talked about how beautifully they are doing. Our present standard for revenue adequacy, based upon the current cost of capital, is 17.7 percent. Now let me give you some figures.

Senator **Warner**. They can be put in the record.

Chairman **Taylor**. We will give you those for the record.

Senator **Warner**. I anticipated your answer. You can put it in the record and that is satisfactory.

[The figures follow:]

CLASS I RAILROADS - 1982 REVENUE ADEQUACY DETERMINATION

RAILROAD	RETURN ON INVESTMENT
EASTERN DISTRICT	
BALTIMORE & OHIO	0.35 %
BESSEMER & LAKE ERIE	0.00 %
BOSTON & MAINE	0.00 %
CHESAPEAKE & OHIO	5.33 %
CONRAIL	0.00 % *
DELAWARE & HUDSON	0.00 % *
DETROIT, TOLEDO & IRONTON	0.00 %
ELGIN, JOLIET & EASTERN	2.70 %
GRAND TRUNK WESTERN	0.00 %
NORFOLK & WESTERN	8.03 %
PITTSBURGH & LAKE ERIE	0.00 % *
WESTERN MARYLAND	5.84 %
SOUTHERN DISTRICT	
ALABAMA GREAT SOUTHERN	4.34 %
CENTRAL OF GEORGIA	6.24 %
CINCINNATI, NEW ORLEANS & TEXAS PACIFIC	7.56 %
CLINCHFIELD	8.02 %
FLORIDA EAST COAST	2.71 %
ILLINOIS CENTRAL GULF	0.00 %
LOUISVILLE & NASHVILLE	4.87 %
SEABOARD COAST LINE	1.33 %
SOUTHERN RAILWAY	4.36 %
WESTERN DISTRICT	
ATCHISON, TOPEKA & SANTA FE	2.66 %
BURLINGTON NORTHERN 1/	4.49 %
CHICAGO & NORTHWESTERN	0.00 % *
CHICAGO, MILWAUKEE, ST PAUL & PACIFIC	0.00 %
DENVER & RIO GRANDE WESTERN	4.53 %
DULUTH, MESABI & IRON RANGE	0.00 %
KANSAS CITY SOUTHERN	7.25 %
MISSOURI-KANSAS-TEXAS	6.96 %
MISSOURI PACIFIC 2/	6.03 %
ST LOUIS-SOUTHWESTERN	4.20 %
SOO LINE	2.96 %
SOUTHERN PACIFIC	0.00 %
UNION PACIFIC	4.43 %
WESTERN PACIFIC 2/	0.00 % *

* DATA SHOWN ABOVE ARE FROM 1982 ANNUAL REPORT FORM R-1'S WITH THE EXCEPTION OF THOSE RAILROADS WITH AN (*) NEXT TO THEIR RETURNS ON INVESTMENT. THESE RAILROADS HAD THEIR ORIGINAL INVESTMENT BASES WRITTEN DOWN DUE TO REORGANIZATIONS. THE ROI'S SHOWN ABOVE WERE COMPUTED USING THE ORIGINAL INVESTMENT BASES (LESS DEPRECIATION) BEFORE THESE WRITEDOWNS. ALL FIVE OF THESE CARRIERS HAD NEGATIVE RETURNS ON INVESTMENT (IE OPERATING LOSSES) FOR 1982.

1/ Includes data for the Colorado and Southern Railway Co. and the Fort Worth and Denver Railway Co. Colorado and Southern was merged into Burlington Northern on January 1, 1982. Effective on that same date, Fort Worth and Denver was given permission by the Commission to file consolidated data with Burlington Northern.

2/ Union Pacific Corp. acquired control of the Western Pacific Railroad Co. and the Missouri Pacific Railroad Co. during 1982. Under the terms of the transaction, the Western Pacific and Missouri Pacific railroads retained their separate corporate existence and, accordingly, continue to file annual reports with the Commission.

Senator **Warner**. Now let's proceed on in whichever order, by virtue of seniority or however you desire.

STATEMENT OF HON. HEATHER J. GRADISON, COMMISSIONER, INTERSTATE COMMERCE COMMISSION, WASHINGTON, DC

Commissioner **Gradison**. Senator, as far as opening statements go, my colleagues, Vice Chairman Sterrett and Commissioner Andre, I just have a brief one that I would like to make which I would be happy to submit for the record. Other than that, we are available to respond to your questions.

Senator **Warner**. Well, you have had the opportunity to hear two sides of this controversy, presented by the coal companies, and then the rebuttal by the rails, and the coal companies presumably may come back to the table to provide as we say in law surrebuttal.

What is your answer to this dilemma? Two facts are incontrovertible. We are losing export markets to nations which have a more competitive production and transportation structure in combination.

Second, we have a growing and inordinate number of unemployed both on the production side and the rail side.

Commissioner **Gradison**. Part of our solution was this decision to exempt export coal from regulation. This decision provides flexibilities for the users and providers of transportation to negotiate without Government interference, and it has been a very carefully weighed decision. It is currently in litigation.

We stand behind the decision and we are attempting to allow it to speak for itself.

[The prepared statement of Commissioner Gradison follows:]

STATEMENT OF HEATHER J. GRADISON, COMMISSIONER
INTERSTATE COMMERCE COMMISSION
BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
OF THE SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
ON THE COAL RAILROAD TRANSPORTATION SYSTEM

November 15, 1983

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear here today to discuss recent ICC actions relating to railroad coal transportation, and specifically the Commission's recent *Export Coal* decision. I agree with and fully support the testimony submitted by the Commission this morning.

I would like to make a brief comment with respect to the Commission's Export Coal decision. I believe the Commission's action in the *Export Coal* proceeding was reasonable, and reflects the Commission's underlying, more market-oriented philosophy. We carefully considered the record in light of the National Transportation Policy and the statutory mandate to grant exemptions whenever regulation is not needed to prevent abuses of market power, and concluded that continued regulation was not necessary.

I would only add an optimistic and confident note that our decisions in this and the other major §10505 exemption cases do far more than just releasing the railroads from needless regulation. These actions give railroads the freedom and flexibility to respond to market opportunities. Our successful experiences with railroad deregulation using the exemption provision, and the particular facts in this case, cause me to believe that allowing a flexible unregulated railroad system rather than requiring a tightly regulated system is the best way to promote the profitable marketing of U.S. coal in highly competitive foreign markets.

Senator **Warner**. Your opinion would be then you would like to see that decision be given an opportunity to work rather than Congress trying to pass more laws?

Commissioner **Gradison**. Yes, sir.

Senator **Warner**. A succinct reply—any other volunteers to the basic problem?

Commissioner **Andre**. Yes.

STATEMENT OF HON. FREDERIC ANDRE, COMMISSIONER, INTERSTATE COMMERCE COMMISSION, WASHINGTON, DC

Commissioner **Andre**. I identify with the remarks of Commissioner Gradison.

Senator **Warner**. Would you speak up just a little more?

Commissioner **Andre**. I identify with the remarks of Commissioner Gradison and would like to add that we are going to watch this one very closely. As was indicated in the reasoning set forth in the case, some of the factors that weigh quite heavily are international—the strength of the dollar and the recent return, as was pointed out earlier this morning, of Poland to its high rank among international suppliers of coal.

Thank you.

Senator **Warner**. Mr. Sterrett.

STATEMENT OF HON. MALCOLM M.B. STERRETT, VICE CHAIRMAN, INTERSTATE COMMERCE COMMISSION, WASHINGTON, DC

Vice Chairman **Sterrett**. Senator, we have tried very hard to follow the congressional intent in terms of actively pursuing exemptions when we find that regulation is not necessary to protect the public from abuse of market power.

However, I think inherent in considering any exemption proceeding there is a certain amount of speculation involved. We think this exemption will work. We did not make the decision upon a purely speculative basis. We made it after a very careful consideration of the very extensive record.

However, should we be proved wrong, should it start to fall apart, we stand ready to reassess that decision on moment's notice.

Senator **Warner**. Another question to the panel—we have heard testimony today that there is an "alleged," and I carefully use that word, price discrimination on coal rates charged for coal bound for export versus coal bound for domestic use.

Under what provision of law or regulation is this alleged price discrimination allowed to occur, and do you care to venture an opinion as to the reasoning behind it from the market standpoint?

Chairman **Taylor**. Well, Mr. Chairman, as you know, export coal is now exempt. Not only is it exempt from rate regulation, it is exempt from all regulations.

As the coal industry witnesses people pointed out this morning, the railroads didn't even ask for that. Originally they did, but they amended their petition to simply ask for exemption from rate regulation. But my colleagues saw fit to push on and go way beyond that and exempt them in effect from everything. I would like at this time, even though I know you are pushed for time, to present my views on the export coal decision.

Senator WARNER. I wonder if we might allow your colleagues to respond to that question? And then I would like to defer to Mr. Ford and then we will get the second part of your testimony.

Commissioner GRADISON. Specifically the portion of the Staggers Act which we used in deregulating export coal was section 10505, and I can read it to you.

Senator WARNER. It is referenced for the record.

Commissioner GRADISON. Section 10505(a) and under that subpart (1) and subpart (2)(b), which specifically says the application of provision is not needed to protect shippers from the abuse of market power and not necessary to carry out the transportation policy, the national transportation policy, and from within our records we deemed that it wasn't, and we went ahead and voted to provide for that exemption, and as Commissioner Sterrett said, this is under close scrutiny by the Commission.

We will continue to review the effects of the decision, and we are prepared at any time to reopen if it is proven necessary, but at this time it certainly isn't. It has only been in effect 2 months.

Senator WARNER. We are looking at discrimination now between export and domestic coal. Would any of the other Commissioners care to comment? Mr. Sterrett.

Vice Chairman STERRETT. I think, as the chairman points out, it is clear that export coal is now exempt, and remedies for unlawful rate activities lie in the courts rather than the Commission.

With respect to the part of the question dealing with the exemption of nonrate issues, the exemption, we said in our notice that we would consider exempting some or all export coal movements from regulation. We received no persuasive evidence that it should be cut back, limiting the exemption to just rate matters, and as Ms. Gradison said, we continue to look at it, but we do not at this time have any evidence or reason not to exempt the rest of the issues.

Commissioner GRADISON. The act clearly states that it should be a broad exemption, that if we go too far in the exemption we can take it back, but the act specifically says to provide for a broad rather than a narrow definition of the exemption.

Senator WARNER. Mr. Andre.

Commissioner ANDRE. Yes; it has been a question from the beginning whether export coal rates necessarily would go up or whether they would go down. I think that is a question which Congress, as I understand it, intended for us to sit back and allow to develop. The intent of the Staggers Act was to move rail service in the direction of demand-based pricing, on the premise that it will restore some health to our rail transportation system and, hopefully, in the long run, make us even more competitive on the international markets.

Senator WARNER. Mr. Ford, would you care to ask questions?

Senator FORD. Oh, I don't know, Mr. Chairman. All of you agree that—go back to Commissioner Sterrett—that if it didn't work, all of you will be willing to review it.

How long did it take you to develop the present regulation that has been in effect 2 months, the rule?

Commissioner GRADISON. This was filed March 1981, so it took 2 years.

Senator FORD. How long will it take you to review it?

Vice Chairman **Sterrett**. Senator, a proceeding is not required under the act. Theoretically we could sit here today and vote right now to revoke the exemption.

Senator **Ford**. There are some in the room who would like you to do that.

Commissioner **Gradison**. So would our Chairman.

Senator **Ford**. But it took you 2 years, though, to come down with the rule.

Vice Chairman **Sterrett**. That is correct.

Senator **Ford**. If you review it, how long will it take you under normal procedure?

Commissioner **Gradison**. As Commissioner Sterrett said, we could do it on a moment's notice, but we would obviously want to do a thorough review and have public testimony, and I would say a minimum of 6 months, but at this moment this Commission is not inclined to open any review, or revocation proceeding, at all.

We would like to see the decision go into effect and see its effects put in place, so my answer to your question is a minimum of 6 months would be a reasonable period of time to consider it.

Senator **Ford**. It won't be done at a moment's notice. That is the point I want to get to.

We have been referred to now as a spot market for export. We are beginning just to fill in what is needed. Our exports declined from about 30 percent of the Japanese market down to 15 or 16 percent. There is some thought given to the export rail rate as getting just the maximum out of it that they can, just squeezing every little bit they can, and that they put the rail rate up to a point where we will just get a little export and put us out of the competition—only those rates that, those purchases based on the spot market.

Do you have any thought that that might happen? I don't see any great competition. Maybe two of those that testified this morning are competitive, and Conrail somewhat, by going $2.50 under the going rate is able to buy some shipments of coal for 12 or 18 months.

Commissioner **Gradison**. As the rail carriers testified, it is both the rail carriers' and the coal producers' interest to participate in the world market to as full an extent as possible, and it is our hope that the flexibility provided for by this exemption will give them an opportunity to negotiate and to then come up with a competitive delivered price in the world market.

Senator **Ford**. That's a good theory. Do you think it is going to happen?

Commissioner **Gradison**. It is in their interest and it is in the country's interest.

Senator **Ford**. Who else is going to carry the coal? Let's get back to coal slurry. What do you think—if we put that in place and Virginia allows it to come through Virginia in the next session of the legislature. What do you think that will do to the coal rates for export?

Commissioner **Gradison**. I guess it will probably bring them down. But, it would depend on the specifics of the market.

Senator **Ford**. You mean they could bring them down anyhow?

Commissioner **Gradison**. I don't know what the costs are today. I don't know what the price structure is.

Senator **Ford**. If you are watching it then, and very closely, if you don't know what the prices are—do you know what the price structure is? How closely are you watching?

Commissioner **Gradison**. I personally am not reviewing this. However, our Bureau of Accounts is, and we have our Office of Transportation Analysis who is monitoring it. We have a whole building of 1,100 people, and I have been assured by Director Southard of the Office of Transportation Analysis that this is under review, and I check with him about once a month to find out how we are doing.

Personally, I don't call the railroads every day and ask them what the price is to move coal because I don't have anything to ship.

Senator **Ford**. That's a pretty good answer. I don't have any to ship either. I happen to be representing people that do, and you happen to be representing those that charge.

Commissioner **Gradison**. I am attempting to do so by assigning that responsibility to the offices within our agency that have that capability.

Senator **Ford**. You have checked with them twice then?

Commissioner **Gradison**. And the decision has been in effect for 2 months.

Senator **Ford**. You have checked with them twice?

Commissioner **Gradison**. Yes, sir.

Senator **Ford**. That's fine. I wanted to understand that. Why would you think that the appointments to the Commission would be so delayed, not being filled, why you don't have a full Commission? Do any of the Commissioners have any thought on that? I go from the Chairman to the Commissioners. It doesn't make any difference who answers it.

Chairman **Taylor**. What shall I do, Senator Ford? We have been waiting a long time.

Senator **Ford**. Mr. Sterrett, do you have any comments?

Vice Chairman **Sterrett**. There are two nominees pending. There is a seventh vacancy for which the administration has not indicated who they will nominate. I do not know what is holding it up.

Senator **Warner**. You have indicated a desire for some more time?

Chairman **Taylor**. I really have not finished my presentation, particularly on export coal.

I would like to point out at the outset to both of you gentlemen that I don't believe the exemption would have been asked for if it were the intent of railroads to lower their rail rates. Please keep that in mind.

They asked for an exemption from regulation, and I am sure they didn't do so because they thought the rates were going to go down. As far as the data is concerned on the exempt coal prices versus domestic prices or what has been happening to them, the answer, Senator Ford, is that it is now exempt. There isn't any way for us to know what those prices are.

The railroads have testified that an awful lot of those rates are now in confidential contracts. As you know, I dissented from the export coal decision. Despite the evidence of record in that proceeding, 95 percent of the mines producing export coal are captive to just one railroad line. The majority is apparently convinced that the nature of the world market combined with the bargaining power of the larger transshippers will provide the necessary constraint against market abuse.

I emphatically disagree with that conclusion, and I regard the exemption as a serious mistake. It is contrary to the intent of Congress. It is unsupported by the evidence of record in the export coal case. In fact, as I pointed out in my dissent, the decision consisted primarily of nothing more than a summarization of the proponent railroads' comments. The export coal decision, to use the language of the U.S. Court of Appeals for the District of Columbia, in a recent opinion, bears the earmarks of a hasty rout, not the measured passage from the old regime to the new for which Congress provided.

With regard to congressional intent, the legislative history of the Staggers Act reflects particular concern over captive coal traffic. Coal was the only commodity singled out for discussion in the various instances, and I would emphasize that Congress did not—let me make that very clear—did not distinguish between domestic and export coal. To the contrary, the floor statements expressed the need for maintenance of reasonable rates on domestic and export coal.

As far as I am concerned, any reasonable analysis must consider the effect of the exemption on both rates and service. Reliance on the world market, on the leverage of a few large shippers, leverage which is questionable at best based on the evidence of record in the proceeding, can only ensure that any coal moving for export will do so at or below the maximum world price.

It will not, however, ensure reasonable rates nor a reasonable division of profits between the railroads and the mine operators, and that is the point Senator Ford has been trying to make, nor will it enable the captive shipper to move its coal if a railroad freed from its common carrier obligation, which didn't have to be done—the railroads didn't even ask for it—determines not to serve the shipper or to condition service upon unreasonable rates.

It should be emphasized that while petitioners sought a limited rate exemption, the Commission on its own nonetheless granted a total exemption from all the provisions of subtitle 4 of title 49, United States Code, despite the fact, I might add, that the record contained not a scintilla of evidence concerning the need for or impact of an exemption from the common carrier obligation, the commodities clause, or the prohibition against discrimination.

There is also a cause for concern about the broader ramifications of exemption, and they are terribly important to me. Our own environmental assessment projected a substantial decline or reduced growth in production for several coal supply regions, including Virginia, and a complete loss of all export production in others. That is our own environmental assessment.

Moreover, in addition to the economic and social effects of these losses, the exemption is in direct conflict with the Administration's effort to stimulate foreign demand for U.S. coal.

Consider, if you will, the manifest contradiction that now exists between the Commission's removal of all pricing constraints on rail movements of export coal on the one hand and on the other the administration's earnest attempt to recapture our former one-third share of the Japanese coal market. Right now, due to the high delivered price of U.S. coal, our share of the Japanese market is only 16 percent. It is estimated that regaining our lost market share would cut $1.5 billion from a projected $22 billion trade deficit with Japan, while providing jobs in addition for some 55,000 Americans. That is just going back from 16 to where we were.

Finally, the potential revocation of this exemption after the abuses have occurred is about as viable an alternative as closing a barn door after the horses have escaped. We heard that same analogy this morning. Foreign markets once lost cannot be easily regained. One does not move easily in and out of the export coal market.

The Commission's ability to revoke the exemption provides only after-the-fact assurances. In order to justify a revocation, the harm would have to occur. Notice would have to be given. Comments would have to be received, and positive action would have to be taken by the Commission. You have already heard the estimate of time it would take to do it. By the time that chain of events takes place, I think I can assure you that damage will have been done, so revocation is at best purely an imagined remedy.

To summarize, the export coal exemption by shifting profit from producer to carrier may well precipitate a long-term decline in coal exports, undercut a key element of U.S. international energy policy, impair the health of the coal mining industry, jeopardize the jobs of thousands, and substantially weaken, if not eliminate, a potentially important factor in our Nation's struggle to regain a favorable balance of trade.

For the record, I have attached to this statement some highlights of my dissent in and the Commission's export coal proceeding.

Senator WARNER. Mr. Taylor, I thank you very much. Unless there are other comments by members of the Commission, I would like to afford on a purely voluntary basis the opportunity for the coal industry to return to the table for any rebuttal they feel could be appropriate.

[Brief pause in the proceedings.]

Senator WARNER. Mr. Massey, would you care to lead off?

Mr. MASSEY. Thank you, sir. The railroads have made some note——

Senator WARNER. Strengthen your voice.

Mr. MASSEY. The railroads have made note of the railroad contract as being an arrangement that one would presumably enter into at arm's length between two parties free to negotiate. We have entered into some of those contracts, and I can say from my personal experience that the negotiation process is to accept anything that the railroads will give us.

When you are captive to their railroads, you have no other choice but to accept that rate or those terms and conditions that they would allow you—an example in part is our settlement of the section 229 complaint. Section 229 did give a window during which one could contest rates as being excessive under the ICC guidelines.

We were faced as the rest of us were in proceeding with that complaint with the cost of massive legal costs, and had we been awarded any kind of a settlement or remunerations under that section 229, those recoveries would have been passed on in effect to the customer or the consumer of the coal. He is the guy that pays the freight rate, so any coverage would belong to the customer of the coal whereas the legal expenses of pursuing this thing through the regulatory process would be entirely those of our company, so what did we do? We traded those 229 cases and you know what we traded them for. We traded them to get rail freight rates to the new terminals that we built at Newport News and Charleston because had we not traded those in that 229 case, we would not have had access to those terminals.

The question of liquidated damages in rail contracts has been brought up. We have been in the coal business for selling coal to customers now since 1916, and sure, liquidated damages is a legal concept that is entered into a contract when one party does not perform, but in the entire 60, 67, 68 years of our company's existence, we have never, never sued a customer for failing to take the amount of coal that he said he would take. If we did so, we would never sell coal to another customer.

Senator WARNER. What about the statement that the rates have since decreased if you follow a constant-dollar formula?

Mr. MASSEY. I don't know what the deflator was that Mr. Snow was using in his constant-dollar factor. I can give you the actual freight rate increases. I have a record of those here, from the years 1977 through 1983 based on a typical freight rate from the Thacker district to Hampton Roads, VA.

Senator WARNER. That would be good. It is important to have that in the record. It will be admitted to the record.

Mr. MASSEY. From 1977 until 1983 those rates increased from $9.02 a ton to $15.72 a ton. Again, they are the tariff rates, and they are not necessarily a contract agreement. New England Electric production has been noted in some cases. We are the company that produced some of the coal for that contract. We lost the contract until that reduction was made. The New England Power Co. who negotiated that reduction did a fine job. I know of no other case where a major customer has been given a reduction anything like what they were given, and that is the only case that we know of in our industry or in our immediate area where that kind of a reduction was made.

Senator WARNER. Mr. Joseph.

Mr. JOSEPH. Yes, sir; thank you for the opportunity for rebuttal. Unfortunately, no one in this room has enough time.

Senator **Warner**. We will allow you to amplify your remarks in the record.

Mr. **Joseph**. I would like first to read to you a letter that was dictated to you over the telephone this morning from the Nordel Fossil Fuel Group, which is a group of Scandanavian power stations. It says: "Dear Senator Warner: With reference to the hearing on November * * *"——

Senator **Warner**. I have read the letter. Summarize it for purposes of the others present.

[The letter follows:]

November 15, 1983

The Honorable John Warner
United States Senate
417 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Warner:

With reference to the hearing on November 15, 1983, on Rail Rate Deregulation, the Nordel Fossil Fuel Group representing the following Nordel Members:

The Elkraft Power Company, Copenhagen, Denmark

Elsam, Fredericia, Denmark

Iamatan Voima, Helsinki, Finland

Norsk Hydro, Oslo, Norway

Sydkraft, Malmo, Sweden

Vattenfall, Stockholm, Sweden

Gathered at a meeting on November 11, 1983 should like to express that as far as their coal imports amounting to several million tons per year are concerned, they consider the United States an important supply source. However, in our view we think that the high tariff of American railroad companies are threatening to egrate the present volume of steam coal to be exported primarily from the east coast, dicriminating volumes on short hauls to loading points on river systems for export out of the Gulf and impeded expanded export volumes.

These circumstances are obstacles for the Nordel Company to purchase from the United States.

We trust this is a matter which will have your support and understanding and we should like to hear from you what steps the United States government or other authorities would be prepared to take in order to achieve desireable improvement.

Yours sincerely,

Nordel Fossil Fuel Group
Kai Bograd Chairman (Elkraft)

Mr. JOSEPH. The summary of the letter is this group of power stations, which buy coal in the United States and like to continue to buy coal in the United States, are concerned about the high level of American rail rates to the extent that they are afraid that it will interfere with and impede their ability to continue to do so.

It is signed by Kai Bograd, a member of the group, and there are six power companies in Denmark, Finland, Norway, and Sweden in that group.

I would like to just take a few minutes to address myself to some of the remarks made by the representatives from the railroads.

First of all, Mr. McKinnon was certainly eloquent and persuasive, but the arguments he used this morning were the the same prior arguments that were used before the ICC and were echoed by the ICC in their decision. It is kind of like hearing a broken record, and a lot of facts that were included in those arguments are simply untrue.

Senator WARNER. Did you have adequate opportunity in the same proceeding to rebut the truthfulness of those allegations?

Mr. JOSEPH. We made the best effort we could, but apparently we weren't as persuasive, Senator.

Mr. Snow said that history is better than logic, and that we are using that same rationale, the same logic.

It was stated that no challenge to rates were made under the regulation. That is simply untrue. I have been in business almost 30 years, and the industry has continually challenged rate increases, but under regulation the policy of the ICC was to grant rate increases without paying much attention to complaints about whether or not they were justified for a particular commodity; the section 299 cases provided the last chance we had to challenge the unreasonableness of rates which had developed in a regulated environment, and this was the reason that the cases were brought in the large group at one time.

If rates were deemed to be unreasonable by the transshippers which had developed under a regulated environment, what can we expect under a deregulated environment? And that is what concerns us here today.

A question was raised about how wonderful contracts are, what they have done for the industry, but I would like to raise another question. If a large percentage of shipments are under contract now which do not permit revenue recovery according to representatives of the railroads, what happens to shippers who for one reason or another cannot make contracts with the railroads when the market recovers and the railroads wish to be at the picnic as one railroad representative has already stated?

It means that those people who for one reason or another are incapable of making contracts with the railroads will have to bear a disproportionate share of the increased revenue that the railroads want to get.

This question of liquidated damages came up. This is a very sensitive question. At the time that the Norfolk & Western at that time made contracts with people the terms of those contracts were such that a great many shippers cannot ship coal under the contracts. They were forced to ship under the normal tariff, and while contract shippers shipped their coal on schedule, other people had ships waiting for days, weeks, and even months because contract ships had priority going into the piers. It cost those people millions of dollars in vessel demurrage.

Now we understand that the railroad has settled cases for liquidated damages which means in effect that unless they reimburse those people who waited and paid demurrage, they are indeed giving a rebate to those people who did not. They had an advantage. They had a penalty if they didn't meet it, and now the penalty has been waived, and for those people who did not have contracts, we would like to know why.

Senator **Warner**. I am going to have to interrupt a minute. Essentially I have to be at a meeting in about 6 or 8 minutes, so recognizing that, I would like to hear from the other two.

Mr. **Joseph**. I defer to Mr. Altmeyer.

Mr. **Altmeyer**. Senator Warner, in deference to your schedule, I want to read one quote from the EIA report which I think bears concern. This is from page 11 of the executive summary.

> As a direct result of higher prices, the United States would face export revenue losses, the railroads would earn greater revenues as a result of the rail rate increases despite hauling smaller tonnages, and the coal industry would lose revenues as coal exports declined.

The major point to be made there is it is in the railroads' economic interest for maximum return on investment to its shareholders to not ship the maximum volume of coal that the market can absorb. It is in their interest to charge prices, higher prices, that do not maximize the volume of shipment because it yields a greater return.

There is a direct economic incentive for them not to expand the use of coal.

One further point, Mr. Chairman, with respect to small, captive shippers, the railroads have said that they wish to cooperate with small, captive shippers. I encourage them to do that. We have not seen any effort from our members of any cooperation by the railroads.

Our members say we have been dictated a price. The railroads will not deviate from that price, and a number of our smaller members have lost potential sales as a result.

Thank you, Mr. Chairman.

Mr. **Moore**. I would like to add one comment, Senator Warner, that fortunately in the West our situation has been different and largely because the railroad through which the export coal has moved has proved more cooperative, so it is not—I don't disagree with the problem in the East. It is just that we haven't had it to date in the West because we are really not talking about a problem with coal or a problem of railroad shipment.

We are talking about a problem of international trade which ought to concern all the eastern railroads as well, and is a problem we ought to work together to try to solve.

Senator **Warner**. There is more than a minute or two left. Mr. Joseph.

Mr. **Joseph**. Thank you very much. I would thank you very much, Senator. I appreciate it.

I would just like to make a few comments on some of the more flip remarks that were passed by the railroad people.

Someone, when they were talking about doing things for small shippers, I think it was Mr. Snow, said well, they are ready to make contracts with them if they can load unit trains. For those in the room who may not know what a unit train is, it is a minimum of 7,000 tons. Most small, captive shippers either don't have the financial ability or don't have the space at their mines to be able to do that, so you effectively shut them out, but you say well, we offered it to them, but you offered it to them knowing they can't comply.

It was also mentioned rate reductions from the overseas buyer. Both Mr. Massey and myself have a fair relationship with most overseas buyers. We haven't heard of any such offers at all.

Just one thing I would like to correct, and thank you for your time, and that was the implication that the ratemaking for New England Electric took place after deregulation. It did not. It took place before deregulation, so the discriminatory rates were in place before the export rates were deregulated.

Senator WARNER. The unit train observation, would you comment on the use of transshipments to achieve the unit trains?

Mr. JOSEPH. I'm sorry, Senator?

Senator WARNER. When you commented on the difficulty with which the small operator deals with unit train problems, then I further asked the question what about the transshipper who does associate with the small shipper?

Mr. JOSEPH. The capability to load unit trains depends upon the individual mining operation, and so if he can't do it, he can't do it no matter who he has to call.

Senator WARNER. Well, gentlemen, ladies, we have had a very exhaustive day. I hope we have provided some airing of this problem and a compilation for the record which will provide a basis for further oversight in the Congress.

I thank all of those who have attended. The hearing record will remain open for 2 weeks to submit statements for the record.

I would like for all parties, including the coal producers panel, to provide if they so desire rebuttals to any and all statements made today so everybody has the opportunity for surrebuttal.

Thank you very much.

[Whereupon, at 12:52 p.m., the hearing was adjourned.]

APPENDIX

Additional Material Submitted for the Record

STATEMENT OF JAN W. MARES*
ASSISTANT SECRETARY FOR FOSSIL ENERGY
U.S. DEPARTMENT OF ENERGY
BEFORE THE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
NOVEMBER 15, 1983

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to appear before this Committee today to discuss policies affecting the nation's coal resources and their role in the nation's energy future. This Administration is committed to an energy system which can provide energy supplies to meet our individual and collective requirements without requiring changes in lifestyle or loss of competitive position in domestic and international markets. Stated more succintly, the goal of our national energy policy is to foster adequate supplies of energy at reasonable costs. We must promote a balanced and diverse energy resource system by developing all of those indigenous resources which can compete in the world energy market.

One of the main means for improving our economic wellbeing is to promote economic efficiency. The Admministration's record in removing the barriers to efficient operation of energy markets need not be recounted here. But we must remember that the important concept underlying these actions is competition. This Administration is committed to removing government-imposed barriers to competition, thereby encouraging the efficient operation of markets. In the past, government over-regulation has severely hampered the efficient development of energy production and transportation industries through price controls and other measures.

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*Submitted for the Record

The Administration will continue to pursue policies which remove constraints to competitive industries. This is fundamental if the interests of consumers are to be protected. We support the improvement of the nation's rail system to assure its long-term viability. At the same time, we believe federal policy should encourage rail rates for coal that allow a competitive export market to develop.

The Role of Coal

Coal has an important role in a balanced and diverse energy resource system. Because it is the nation's most abundant fossil fuel, coal has great potential for supplying a significant portion of the nation's and the world's future energy requirements. Coal is an economically attractive energy resource when compared to oil and natural gas. This is particularly true for the electric utility sector which uses 71 percent of domestic coal production. In 1982, the delivered cost of coal to electric utility plants was 164.7 cents per million BTU compared to 340.6 cents for gas and 475.5 cents for residual oil. With the cost of coal in electricity generation about one-half the cost of gas and one-third the cost of oil, it is not surprising that coal is used to generate 53 percent of the nation's electricity, or that the industry plans to use more coal in the future.

Coal has similar value to our allies who also are seeking to reduce their oil dependency. U.S. coal exports historically represent about 10 to 15 percent of annual production and have the potential for increasing if the U.S. can be competitive in the world market. Many importers of U.S. coal believe that the minemouth cost of U.S. coal is competitive, but in many cases, inland and ocean transportation costs are too high and, therefore, delivered prices are excessive.

An economically efficient transportation system is an important factor affecting the future of coal. Between 60 and 70 percent of all U.S. coal moving to market is hauled by the railroads. While the minemouth price of coal has been declining since 1975, the real delivered price rose over 20 percent (or in nominal terms, the delivered price rose over 102 percent) between 1975 and 1982. Rail shipping costs on average comprise over 30 percent and, in selected cases, as much as 70 percent of the delivered price of coal and this percentage is steadily increasing.

The Competition Factor

The competitive rail transportation system is vital to a competitive coal industry. From the work done within the Department, we can state with assurance that the U.S. coal producing industry is workably competitive. No one company or group of companies in any market in the country has sufficient market power to raise the minemouth price of coal above competitive levels. The structure of the coal producing industry is characterized by many low market-share companies vying for the right to sell coal. There also are a substantial number of companies that can enter quickly to supply spot sales should the price of coal start to climb. The ease with which new producers can enter the coal producing industry creates sufficient potential competition to keep in check any attempt by existing producers to raise prices above competitive levels.

The largest purchasers of coal are the electric utilities. Some utilities buy large amounts of coal on a long-term basis, usually 20 to 30 years. Competition among coal producers for these long-term contracts is quite intense, since there are many existing or potential producers which seek to fulfill the requirements of the contract.

Under the Staggers Rail Act, railroads and coal shippers may enter into contracts that are not subject to the regulatory jurisdiction of the ICC. Utilities and railroads can build in a variety of price escalators assuming both parties are willing to enter long term contracts. Under terms of such contracts, railroads cannot increase rates unilaterally. There can be intense competition for these long-term rail contracts where transportation alternatives exist. Where such alternatives are not available, however, or where such contracts are not negotiable, utilities may have more difficulty in obtaining rates for coal shipments that reflect a competitive situation. We recognize that not every coal rail movement occurs through long-term contracts, but the availability of contracts is an important factor in improving competition.

Rail Rates and the Domestic Market

As I stated in my introduction, the majority of coal that moves in the country is hauled by railroads, accounting for 60 to 70 percent of all coal movements. Approximately 40 percent of all rail traffic is coal, representing 24 percent of total revenues.

Today, coal movements are concentrated among a small number of railroads. In 1982, four rail systems originated 82 percent of all rail coal traffic. With the ICC permitting mergers of large rail systems, the national rail system is evolving to the point where several major systems dominate rail movements. Yet, there may be benefits as these remaining systems become stronger and can provide a greater degree of competition. A good example is the entry this year of the Chicago and Northwestern Railroad into the Powder River Basin, providing the first significant competition to the Burlington Northern Railroad.

The Interstate Commerce Commission is implementing the intent of deregulation expressed in the Staggers Rail Act and the Railroad Revitalization and Regulatory Reform Act (4-R Act), through various proceedings and rulemakings. Specifically, the rulemakings concerning market dominance and captive coal rail rates are designed to safeguard any captive shipper from excessively high rates by setting upper bounds for rate increases.

The Energy Department submitted formal comments to the Interstate Commerce Commission on July 28, 1983, regarding these interim coal rate guidelines. In the introduction to those comments, we stated:

> "The Department of Energy agrees with the fundamental policy of the Staggers Act to maximize the use of market forces to determine rates on competitive coal traffic.... We are concerned, however, that in the limited context of this proceeding, which only concerns those rates which remain subject to ICC rate regulation, that the Commission may be permitting railroads to charge more than an appropriate amount for captive coal shipments in order to achieve revenue adequacy without distributing this goal among other captive classes of traffic."

As we also stated in comments to the ICC, we do not mean to imply that the rates on other captive classes of traffic should be permitted to rise to the same level as captive coal shipments. All we mean to imply is that captive coal should bear no more than its fair share of the goal of revenue adequacy. From our perception of the proposed ICC guidelines, the Department has the impression that captive coal may be asked to carry more than this fair share.

We concluded in our July 28 comments that:

> "The thrust of the Commission's proposed coal rate guidelines seems to be to achieve the goal or rail revenue adequacy through rate increases just on captive coal shipments disregarding the contribution to this goal from other captive shipments and from competitive traffic. We perceive from the 15 percent phasing discussion that revenue adequacy can be achieved for those railroads with significant coal revenues just by increasing rates on captive coal shipments without consideration of the contribution made by other captive or competitive traffic. If this perception is correct, then this interpretation of the 4-R Act and the Staggers Act deeply disturbs the DOE, since it clearly does not strike the appropriate balance among carriers, shippers, and the public and clearly permits carriers to price captive coal shipments at the level of whatever the traffic will bear. The courts had held that this is not permissible and is not reasonable maximum rate regulation....If the DOE analysis is correct, then the proposed coal rate guidelines do not follow the statutory requirements of the 4-R Act and Staggers Act and are inconsistent with national energy policy."

(Attached to this testimony is a complete copy of the Department's July 28, 1983, comments to the ICC regarding the interim rail rate guidelines.)

The situation of the captive shipper takes on particular significance when one recognizes that despite the existence of competitive pressures in the coal producing industry and the electric power industry, nearly 85 out of every 100 tons of coal produced in the U.S. and shipped by rail was found to be captive according to a 1979 survey "Study of Captive Coal Shipments by Rail" conducted by the National Coal Association. The study also revealed that "coal shipments to electric utilities, the largest consumer for coal, were found 83% captive to one rail route."

Rail Rates and the Export Market

The export market for coal traditionally has been about 10 percent of domestic production but rose to 13 and 12 percent of domestic production (110 million tons and 105 million tons) in 1981 and 1982 respectively.

Prospects for this year and next year are not as promising. The first nine months of 1983 indicate 56.97 million tons exported, which is approximately 70 percent for a comparable period for 1982 and 1981. The estimated total 1983 tonnage is uncertain but expectations are that it will be less than 80 million tons.

Where increased coal supplies are needed, other exporting countries are expected to be able to fill the demand at prices lower than the U.S. can offer. The U.S. will continue to be considered the "swing" supplier in the world market.

Many factors contribute to the recent decline of U.S. coal exports -- the strength of the dollar, lower than expected oil prices, increased conservation, and the recession. Japanese and European energy experts argue that U.S. coal mine costs and port charges compare favorably with other suppliers but that inland and ocean transportation costs are unreasonable.

The ICC recently deregulated rail rates on export coal traffic. While preliminary investigations indicate that excess railroad and port capacity have placed downward pressure on rates in 1983, projecting the long-term impacts of deregulated transportation rates is difficult.

Still, the opportunity for coal shippers and/or importers to negotiate rates with the railroads offers the prospect of greater stability -- both of supply and of rates -- over the long run if the railroad indicates a willingness to negotiate for a contract rate.

The present deregulatory environment was created by the 4-R Act and the Staggers Rail Act of 1980. The purpose of these Acts was to bring financial health to the railroad industry by loosening the regulatory constraints within which the railroads operated since 1887. To a significant extent these Acts have been successful in revitalizing railroad financial health.

The ICC has determined that sufficient competition exists to warrant exempting from regulation export coal rail traffic. The Commission is now considering what guidelines to set in determining how to regulate domestic coal traffic. The Department, as I have noted, has submitted its views to the Commission on this issue and will continue to make our expertise available.

This concludes my statement. I would be glad to answer any questions you may have.

BEFORE THE
INTERSTATE COMMERCE COMMISSION

COAL RATE GUIDELINES, NATIONWIDE: EX PARTE NO. 347 (SUB. NO. 1)

COMMENTS OF THE UNITED STATES DEPARTMENT OF ENERGY

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July 28, 1983

BEFORE THE

INTERSTATE COMMERCE COMMISSION

COAL RATE GUIDELINES, NATIONWIDE: EX PARTE NO. 347 (SUB-NO. 1)

COMMENTS OF THE DEPARTMENT OF ENERGY

The Department of Energy (DOE) is concerned about the impact of the proposed coal rate guidelines on national energy policy. The DOE perceives that these proposed guidelines do not strike the appropriate balance among the competing policies and interests that the Interstate Commerce Commission (ICC) must consider in reaching its decision on this important and sensitive issue.

I. INTRODUCTION

This proceeding concerns the appropriate maximum reasonable rail rates applicable to captive coal traffic, that is, the maximum level of rates in those limited situations where there is no competitive alternative to transport coal. The Department of Energy agrees with the fundamental policy of the Staggers Act to maximize the use of market forces to determine rates on competitive coal traffic. The Department of Energy agrees with the overall thrust of this proceeding that differential pricing relying upon the elasticities of demand for each type of traffic carried, coal or otherwise, is an appropriate pricing principle. We are concerned, however, that in the limited context of this proceeding, which only concerns those rates which remain subject to ICC rate regulation, that the Commission may be permitting railroads to charge more than an appropriate amount for captive coal shipments in order to achieve revenue adequacy without distributing this goal among other captive classes of traffic. We do not mean to imply by this statement that the rates on other captive classes of traffic should be permitted to rise to the same level as captive coal shipments, since that would not be in keeping with the principle of differential pricing espoused in the proposed guidelines. All we mean to imply is that captive coal should bear no more than its fair share of the goal of revenue adequacy. From DOE's perception of the proposed guidelines, we have the impression that captive coal may be asked to carry more than this fair share. If this is an appropriate perception, we request the ICC to reconsider its proposed guidelines in light of its statutory mandate to consider national energy policy and its requirement to strike a balance among carriers, shippers, and the public.

Our national energy policy is predicated on providing adequate supplies of energy at reasonable prices. The strategy to achieve these goals focuses on maximizing the use of market forces and achieving a balanced and diverse energy mix. The role of coal in that energy policy and energy mix is important because it is one of the largest domestic fuel resources. While the DOE does not fear competition among fuels relying upon market forces, since that competition promotes economic efficiency, we are concerned that government policies should not impose artificial distortions on competitors. Therefore, even though the Commission may be attempting to promote competition through reliance on market forces, at the same time its policies in this proceeding may be leading to some market distortions if captive coal shipments contribute more than their fair share toward the goal of revenue adequacy.

II. STATUTORY REQUIREMENTS REGARDING ENERGY POLICY

The ICC is required statutorily to consider the impact of its actions on national energy policy. One of the goals of rail transportation policy is

> to encourage and promote energy conservation.

49 U.S.C. 10101a(15).

The ICC also is charged with considering

> the impact of the proposed rate or rate increase on the attainment of the national energy goals and the rail transportation policy under section 10101a of this title, taking into account the railroads' role as a primary source of energy transportation and the need for a sound rail transportation system in accordance with the revenue adequacy goals of section 10704 of this title.

49 U.S.C. 10707a(e)(2)(B)(iii).

The DOE is aware that the major purpose of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976) (hereinafter 4-R Act) and the Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895 (1980) (hereinafter Staggers Act) is to improve the physical and financial stability of the nation's rail system. This stability is essential in order to achieve many of the nation's energy goals as well. In its declaration of findings, Congress recognized that in passing the Staggers Act

> modernization of economic regulation for the railroad industry with a greater reliance on the marketplace is essential in order to achieve maximum utilization of railroads to save energy and combat inflation.

Section 2(9) of Pub. L. 96-488, 94 Stat. 1896, 49 U.S.C. 10101a, historical note.

In addition to its consideration of national energy goals, its consideration of the effects upon energy conservation, and its goal of maximizing the use of railroads to save energy, the Commission must

> provide a regulatory process that balances the needs of carriers, shippers, and the public.

4-R Act, section 101(b)(1), 90 Stat. 33, 45 U.S.C. 801 (b)(1); Staggers Act, section 3(4), 94 Stat. 1897, 49 U.S.C. 10101a, historical note; Houston Lighting & Power Co. v. United States, 606 F.2d 1131, 1149 (D.C. Cir. 1979).

Moreover, the Commission must factor in

> the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues

in its determination of reasonable rates. 49 U.S.C. 10707a(e)(2)(C)(iii). Thus the Commission, in its determination of what is a reasonable rate in the absence of effective competition, cannot permit the carriers to charge whatever the traffic will bear. Houston Lighting & Power Co. v. United States, 606 F.2d 1131, 1148, 1149 (D.C. Cir. 1979), cert. denied, 444 U.S. 1073 (1980), and Union Pac. R. Co. v. United States, 637 F. 2d 764, 767, N.2 (10th Cir. 1981).

It is incumbent upon the Commission to strike a balance among the various interests affected by this rulemaking. The Department of Energy perceives that the proposed coal rate guidelines may not strike that balance, and therefore, the Commission should reconsider these guidelines.

III. NATIONAL ENERGY POLICY AND COAL

The goal of current national energy policy is to provide adequate supplies of energy at reasonable prices. National energy policy promotes economic efficiency in the production and use of energy, doing so in a manner that ensures national security, preserves environmental quality, and protects public health and safety. The strategy to achieve these goals focuses on two elements: maximizing the use of market forces to provide energy to the nation as a whole, as well as regions, states, and localities with varying requirements, and promoting the development of a balanced and diverse energy system.

Balance and diversity in our national energy policy means that all fuels should have a place in our energy production system. Certainly one of the nation's largest fuel resources is coal. National energy policy has attempted to remove barriers to increased use of the nation's coal resources. For example, government leasing policies have emphasized increased coal leasing as a way of increasing the potential resource base in private hands and susceptible to development. This leasing policy has a salutory effect on coal development and the adequacy of coal at reasonable prices. Other policies, such as government-sponsored research and development, and the reduction of the burden imposed on the coal industry from surface mining laws or on coal users from environmental laws, all assist the development of our coal resources at reasonable prices.

The primary user of coal is the electric power industry. Coal-fired generation now comprises 53.2 percent of all electricity generated. This has increased substantially over the years due, in part, to the price of alternatives and also due, in part, to the national emphasis on using coal rather than more highly valued fuels such as oil and gas. We are now at the point where over 80 percent of the coal consumed domestically is consumed by the electric power industry and this trend is expected to continue for the foreseeable future.

Electricity costs are sensitive to the price of fuels used to generate electricity. As the price of fuel increases, regulatory agencies permit passthroughs of these costs. For coal-fired generation the coal cost component generally is the largest single cost of producing electricity averaging about 50 percent. [The fuel component ranges from a low of 28 percent in the south central U.S., where mine mouth lignite-fired plants are found, to a high of 55 percent in New England and the northwest U.S. Andrew Reynolds, Projected Costs of Electricity from Nuclear and Coal-Fired Power Plants (Department of Energy, DOE/EIA-0356/1, Washington, D.C.: 1982).] While the mine-mouth price of coal is an important component of the delivered price of coal, the transportation component looms large. On a national average, the transportation component represents about 30 percent of the delivered price of coal. But in the west, particularly where the line haul is much longer, the transportation element can represent as much as 40 to 60 percent of the delivered price. Thus, increasing transportation costs have a direct effect on the delivered price of coal and a direct effect on the price of electricity. [For a discussion of the effects of higher fuel prices on electricity prices see David E. Serot and John W. Makens, Effects of New Plant and Equipment Expenditures on Electricity Prices (Department of Energy, DOE/EIA-0346, Washington, D.C.: 1982).]

Under the Commission's proposed rules, everything else remaining the same, the major coal hauling railroads, on average, are expected to achieve revenue adequacy in eight years, using the 15 percent phasing of rates. Coal Rate Guidelines, Nationwide, p. 18. Some could achieve revenue adequacy much earlier, (four railroads are expected to reach revenue adequacy in one year) and some much later (one is expected to reach revenue adequacy in 10 years and another in 16 years). Using the ICC formula for achieving revenue adequacy--average rate increases of 29 percent in 1985, 71 percent in 1990, and 90 percent in 1995 over the base year of 1981--the Energy Information Administration (EIA) of DOE made calculations to determine the effects of increases on both coal production and coal consumption. This analysis has been made available to the Commission and will be published in the near future under the title, Railroad Deregulation: Impact on Coal. It should be noted that the EIA study is used here for illustrative purposes only. The DOE has not completed its analysis of the underlying assumptions used by EIA to compute the figures; however, DOE tentatively concludes that the EIA results understate the actual effects on production and consumption.

Calculations were made of the overall production declines in each of the years: -2 percent in 1985, -5 percent in 1990, and -5 percent in 1995. The differential impact between the east (east of the Mississippi) and west (west of the Mississippi), however, is substantial. Where eastern coal production increases slightly in 1985 and 1990, western coal production drops substantially. In 1995, coal production drops below what it otherwise would be in both the east and west. Table I indicates the magnitude of these changes.

These changes indicate clearly the impact of increased coal rates on coal production as the transportation component of captive shipments increases relative to the mine-mouth price. While there is virtually no impact in the east, where line hauls are much shorter, in the west the impact is substantial with production decreases of 7.4 percent, 15.2 percent, and 13.3 percent.

If the 15 percent phasing is examined so that rail rates double in five years with no inflation and rail rates double in less than four years with 5 percent inflation, coal production declines even more. [Note the 15 percent phasing continues unfettered until the revenue adequacy cap is reached. For some railroads this cap is not reached within the time period when rates double.] Table II indicates what happens to coal production with straight percentage rail rate increases disregarding achievement of revenue adequacy. For example, if rates double in 1985, that is, they increase by 100 percent, then total coal production declines by 4.6 percent as opposed to 2.3 percent in the revenue adequacy case reflected in Table I. Western coal production declines by 11.5 percent in 1985 if rates double versus a 7.4 percent decline with revenue adequacy. In 1990, if rates double, overall coal production declines 6.9 percent and western coal production declines 17.4 percent versus 5.0 percent and 15.2 percent in the revenue adequacy case.

In the revenue adequacy case, utilities throughout the United States will decrease their use of coal: -4.9 million tons in 1985, -20 million tons in 1990, and -27.1 million tons in 1995. See Table III. While the percentage declines are not that substantial---0.8 percent in 1985, -2.6 percent in 1990, and -2.9 percent in 1995--they do indicate that utilities have little ability to switch away from coal consumption, especially once they make their commitments to burn coal in their generating plants. Future generation choices, however, will be affected also and the choices will shift away from coal to alternatives. The coal consumption effects from straight percentage rail rate increases are presented in Table IV.

These coal production and coal consumption declines will have a substantial impact on the coal industry and on the electric power industry. These effects will be felt on competition in the coal industry and on the electric power industry's choices for coping with environmental problems.

From a competitive viewpoint, the effects can be substantial. Competition for long-term coal supply to electric power plants takes place before the plant is constructed. Coal producers bid on the coal requirements for that plant sometimes even before the coal mine is producing. Electric power companies evaluate the bids based upon the price of the coal, the quality of the coal, and a plethora of other factors. One of the crucial elements in the decisionmaking process is the cost of transportation to the plant site. As the cost of transportation goes up, the choices confronting the electric power company start to shift and shrink. Coal producers that are further away may find their ability to compete for long-term contracts impaired because the delivered price is noncompetitive. These coal producers may lose out to coal producers that are closer or in different geographic regions. Thus there is bound to be a shift in coal production away from areas where the delivered price of coal is too high in comparison to other coal sources. Low-cost sources of coal may go unexploited due to noncompetitive rail rates, while high-cost, noncaptive coal sources may expand, imposing additional costs on society. The alternatives that the electric power company can choose from may decline, making the bidding process less competitive. Since entry into coal production often is dependent upon successful bids on long-term contracts, increased entry barriers in the form of higher transportation rates may limit competition in the production of coal. All of these effects can occur as transportation costs escalate faster than the mine-mouth cost of coal.

Coal producers may lose out altogether as coal consumers switch away from coal to other fuels, such as oil, gas, and nuclear. If the delivered price of coal climbs too high, coal consumers may decide that an alternative fuel is less costly, especially taking into account the lesser physical and environmental problems associated with some fuels, such as natural gas. Thus the coal industry may become less competitive with other fuels. While the DOE does not fear healthy competition among fuels to achieve the most efficient result, artificial and government-imposed distortions, even if they are limited to captive coal shipments, should be avoided if the nation is to utilize the most efficient mix of fuels. Imposing artificially high rail costs on some coal producers misallocates our nation's resources leading to less than optimal production and consumption decisions and losses in consumer welfare.

These declines imply that electric utilities will turn to other fuel sources for generation capacity additions. The alternatives are nuclear, gas, or oil. The future incremental supplies of oil and gas are imports. Thus, noncompetitive transportation costs could increase our dependence upon imported fuel sources and our vulnerability to disruptions of these fuel sources.

There is a less obvious, but substantial impact upon consumers, if it becomes too costly to use coal in base-load electric generation. The DOE has estimated that through the year 2000 the United States will require about 438 gigawatts (a gigawatt is 1000 megawatts) of new generating capacity (about a 77 percent increase over existing 1981 generating capacity of 572 gigawatts). Department of Energy, The Future of Electric Power in America: Economic Supply for Economic Growth, (Department of Energy, DOE/PE-0045, Washington, D. C.: June 1983), ES-8, Chapter 4. Part of this growth comes from the need to displace generation from high-cost fuels--oil and gas. As the cost of coal increases the economics of displacing these high-cost fuels worsens. If this generation capacity is not replaced, the costs will be enormous. The failure to pursue economic investments in new supply will have a substantial adverse impact on electric prices, while at the same time, increasing oil import levels and serving as a damper on economic growth. Id., at ES-13.

Increased transportation costs and the consequent increase in delivered coal prices will have an effect on electric power company decisions concerning the environment. Many utilities are faced with the problem of complying with the Clean Air Act in order to reduce sulfur emissions. The trade-off often is between high sulfur coal with high cost scrubbers or low sulfur coal either without scrubbers or less costly scrubbers. For many midwestern utilities, this means using locally produced high sulfur coal versus western produced low sulfur coal. Transportation costs for captive shipments may affect this trade-off.

Finally, there is the potential effect of loss of coal traffic altogether as well as to other modes of transportation. Based on rate increases to achieve revenue adequacy, coal movements decline 7.5 percent in 1985, 18.2 percent in 1990, and 13.3 percent in 1995. See Table V. Rail revenues still increase, however, due to the large rate increases permitted under the guidelines. Rail movements decline faster than overall coal movements decline: -9.4 percent in 1985, -22.9 percent in 1990, and -22.4 percent in 1995. As a consequence, rail movements comprise a smaller percentage of the total coal movements dropping from 92.7 percent of all coal movements in 1985 to 84.5 percent by 1995. These shares are lower than they otherwise would be without the substantial rate increases, since without them rail movements would comprise 94.6 percent of all coal movements in 1985, and 94.4 percent of all coal movements in 1995. Thus rail movements, while increasing absolutely, decline relatively over the time period. The major beneficiary is water movements increasing 24.7 percent in 1985, 90.6 percent in 1990, and 139.6 percent in 1995.

While rail transportation loses a significant portion of coal movements because of rate increases, the differential effect between east and west is more pronounced. For eastern rail movements, the declines are -4.7 percent for 1985, -13.7 percent for 1990, and -15.5 percent for 1995. But in the west where rail line hauls are much longer, and where coal production declines are much larger, the railroads experience declines of -13.7 percent in 1985, -31.1 percent in 1990, and -28.9 percent in 1995. See Table V.

IV. CONCLUSION

The thrust of the Commission's proposed coal rate guidelines seems to be to achieve the goal of rail revenue adequacy through rate increases just on captive coal shipments disregarding the contribution to this goal from other captive shipments and from competitive traffic. We perceive from the 15 percent phasing discussion that revenue adequacy can be achieved for those railroads with significant coal revenues just by increasing rates on captive coal shipments without consideration of the contribution made by other captive or competitive traffic. If this perception is correct, then this interpretation of the 4-R Act and Staggers Act deeply disturbs the DOE, since it clearly does not strike the appropriate balance among carriers, shippers, and the public and clearly permits carriers to price captive coal shipments at the level of whatever the traffic will bear. The courts had held that this is not permissible and is not reasonable maximum rate regulation. Houston Lighting & Power v. United States, supra, and Union Pac. R. Co. v. United States, supra. If the DOE's analysis is correct, then the proposed coal rate guidelines do not follow the statutory requirements of the 4-R Act and Staggers Act and are inconsistent with national energy policy.

V. RECOMMENDATION

The Department of Energy respectfully requests the Commission to reconsider its coal rate guidelines to take into account our national energy policy and to reconsider the guidelines giving the appropriate balance among carriers, shippers, and the public.

Respectfully submitted

ROBERT C. ODLE, JR.
Assistant Secretary for Congressional,
Intergovernmental and Public Affairs

LEONARD L. COBURN
Director
Office of Competition

July 28, 1983

Table I

U. S. Coal Production
(Million Short Tons)

Region	Actual	Base			Change from Base for Revenue Adequacy					
	1981	1985	1990	1995	1985	%	1990	%	1995	%
Eastern U.S.	553.9	573.6	644.7	810.4	3.3 (576.9)	0.6	11.0 (655.7)	1.7	-4.4 (806.0)	-0.5
Western U.S.	269.9	328.9	425.4	492.0	-24.2 (304.6)	-7.4	-64.7 (360.7)	-15.2	-65.6 (426.4)	-13.3
Total U.S	823.8	902.4	1,070.1	1,302.4	-20.9 (881.5)	-2.3	-53.7 (1,016.4)	-5.0	-70.0 (1,232.4)	-5.4

Source: EIA forthcoming publication Railroad Deregulation: Impact on Coal.

Note: Policy, Planning and Analysis of DOE projects different base case production totals--954.0 in 1985, 1,098.0 in 1990, and 1,286.0 in 1995. These projections have not been used in the EIA model so that estimates of potential changes cannot be made. If the percentage changes are in the same order of magnitude, the absolute changes will be more pronounced.

Table II

U. S. Coal Production
(Million Short Tons)

Region	Base	Rail Rate Increase Cases Change from Base 50 Percent Tons	50 Percent %	75 Percent Tons	75 Percent %	100 Percent Tons	100 Percent %	150 Percent Tons	150 Percent %
1985									
Eastern U. S.	573.6	2.9	0.5	-0.6	-0.1	-4.2	-0.7	-18.4	-3.2
Western U. S.	328.9	-31.9	-9.7	-34.8	-10.6	-37.7	-11.5	-43.4	-13.2
Total U. S.	902.4	-29.0	-3.2	-35.4	-3.9	-41.9	-4.6	-61.7	-6.8
1990									
Eastern U. S.	644.7	8.4	1.3	8.5	1.3	0.8	0.1	-12.0	-1.9
Western U. S.	425.4	-55.8	-13.1	-67.7	-15.9	-74.2	-17.4	-82.1	-19.3
Total U. S.	1,070.1	-47.4	-4.4	-59.3	-5.5	-73.5	-6.9	-94.1	-8.8
1995									
Eastern U. S.	810.4	1.9	0.2	1.5	0.2	-11.8	-1.5	-26.4	-3.3
Western U. S.	492.0	-47.6	-9.7	-64.5	-13.1	-68.9	-14.0	-79.6	-16.2
Total U. S.	1,302.4	-45.7	-3.5	-63.1	-4.8	-80.7	-6.2	-106.0	-8.1

Source: EIA forthcoming publication Railroad Deregulation: Impact on Coal.

Table III

Domestic Coal Consumption
(Million Short Tons)

Sector	Actual	Base			Change from Base for Revenue Adequacy					
	1981	1985	1990	1995	1985	%	1990	%	1995	%
Utilities	596.8	655.6	770.5	929.5	-4.9	-0.8	-20.0	-2.6	-27.1	-2.9
Industrial	67.4	77.1	93.6	119.4	-0.5	-0.6	-5.9	-6.3	-4.5	-3.8
Metallurgical	61.0	49.1	51.9	65.5	-0.5	-1.0	-1.5	-2.9	-2.7	-4.1
Residential/ Commercial	7.4	6.9	6.0	3.9	--	--	0.1	1.7	--	--
Synthetics	--	5.5	5.5	11.4	--	--	--	--	-0.1	-0.9
Total	732.6	794.2	927.5	1,129.6	-6.0	-0.8	-27.3	-2.9	-34.3	-3.0

Source: EIA forthcoming publication Railroad Deregulation: Impact on Coal.

Table IV

Domestic Coal Consumption
(Million Short Tons)

Sector	Base	Rail Rate Increase Cases Change from Base							
		50 Percent		75 Percent		100 Percent		150 Percent	
		1985							
		Tons	%	Tons	%	Tons	%	Tons	%
Utilities	655.6	-7.6	-1.2	-8.7	-1.3	-10.4	-1.6	-16.5	-2.5
Industrial	77.1	-2.1	-2.7	-3.4	-4.4	-4.2	-5.4	-5.7	-7.4
Metallurgical	49.1	-0.9	-1.8	-1.4	-2.9	-1.8	-3.7	-2.5	-5.1
Total*	794.2	-10.6	-1.3	-13.5	-1.7	-16.4	-2.1	-24.7	-3.1
		1990							
		Tons	%	Tons	%	Tons	%	Tons	%
Utilities	770.5	-17.5	-2.3	-22.2	-2.9	-25.6	-3.3	-32.6	-4.2
Industrial	93.6	-5.6	-6.0	-8.6	-9.2	-11.2	-12.0	-15.4	-16.5
Metallurgical	51.9	-1.0	-1.9	-1.5	-2.9	-1.9	-3.7	-2.8	-5.4
Total*	927.5	-24.1	-2.6	-32.2	-3.5	-38.6	-4.2	-50.7	-5.5
		1995							
		Tons	%	Tons	%	Tons	%	Tons	%
Utilities	929.5	-18.0	-1.9	-26.8	-2.9	-32.5	-3.5	-41.7	-4.5
Industrial	119.4	-3.2	-2.7	-4.7	-3.9	-5.8	-4.9	-8.4	-7.0
Metallurgical	65.5	-1.3	-2.0	-1.9	-2.9	-2.3	-3.5	-3.3	-5.0
Total*	1,129.6	-22.4	-2.0	-33.3	-2.9	-40.7	-3.6	-53.3	-4.7

* Total includes two additional categories--Residential/Commercial and Synthetics. The impacts upon these categories are negligible as indicated in Table III and therefore they have not been segregated in this Table.

Source: EIA forthcoming publication Railroad Deregulation: Impact on Coal.

Table V

Domestic Coal Movements
(Billions of Ton-Miles)

Transportation Mode	Base			Change from Base for Revenue Adequacy					
	1985	1990	1995	1985	%	1990	%	1995	%
Total Rail	383.1	469.2	544.6	-35.9	-9.4	-107.2	-22.9	-121.8	-22.4
East	178.1	219.2	266.4	-8.3	-4.7	-29.5	-13.5	-41.3	-15.5
West	205.0	250.0	278.2	-27.6	-13.5	-77.7	-31.1	-80.5	-28.9
Total Water	21.9	20.2	32.3	5.4	24.7	18.3	90.6	45.1	139.6
Total Movements	405.0	489.4	577.0	-30.5	-7.5	-88.9	-18.2	-76.6	-13.3

Source: EIA forthcoming publication *Railroad Deregulation: Impact on Coal*.

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November 29, 1983

Mr. Roger Sindelar
Counsel
Energy and Mineral Resources
Subcommittee
Senate Committee on Energy and
Natural Resources
306 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Sindelar:

Enclosed please find two copies of the statement of W.R. Miller, Chairman of the Eastern Coal Transportation Conference, which is submitted for inclusion in the record of the Subcommittee's November 15 hearing on railroad coal rates and the Interstate Commerce Commission's implementation of the Staggers Rail Act of 1980.

Mr. Miller was unable to appear in person before Chairman Warner and the Subcommittee. As an organization of small to medium-sized Eastern coal producers, however, ECTC is vitally interested in the important issues raised during the hearing. We therefore respectfully request that ECTC's views be included in the record through the statement of its Chairman.

Thank you for your consideration in this matter.

Sincerely,

Kelvin J. Dowd

KJD/jk

STATEMENT OF W.R. MILLER
ON BEHALF OF THE
EASTERN COAL TRANSPORTATION CONFERENCE
BEFORE THE ENERGY AND MINERAL RESOURCES SUBCOMMITTEE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

STATEMENT OF W.R. MILLER
ON BEHALF OF THE
EASTERN COAL TRANSPORTATION CONFERENCE
BEFORE THE ENERGY AND MINERAL RESOURCES SUBCOMMITTEE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

Mr. Chairman and members of the Subcommittee. My name is W.R. Miller, and I am the Chairman of the Eastern Coal Transportation Conference. ECTC is an association of twenty-two small to medium-sized coal producers and owners of coal producing properties located east of the Mississippi River. It is the successor to the Property Owners' Committee, an organization which was founded in 1926. A list of ECTC's members is attached to my statement as Appendix I.

Because a coal producer's ability to market its product successfully is directly related to the costs its customers must pay to transport it, coal producers such as ECTC's members have a vested interest in preserving reasonable Eastern coal transportation rates. As a result, ECTC has actively participated in a number of administrative proceedings before the Interstate Commerce Commission involving matters relating to coal transportation, and has been a party to a number of proceedings in the federal courts to review the Commission's decisions in these proceedings.

ECTC agrees in principle with the theory espoused by Congress in the Staggers Rail Act of 1980: where effective transportation competition is firmly in place, regulation of railroad rates and services practices by the ICC is unecessary and, indeed, undesirable. In the absence of effective competition, however, action by the ICC to restrain monopolistic carrier rates and service practices is absolutely essential. The purpose of my testimony is to provide the Subcommittee and Congress with the benefit of the views of smaller Eastern coal producers with regard to various actions of the ICC over the past three years through which the Commission has implemented and administered the Staggers Rail Act. It is, unfortunately, our conclusion that at least with regard to coal -- a commodity which is a virtual prisoner of the railroad industry -- the ICC has totally failed in its mission to protect producers and shippers from abuse of the railroads' monopoly power.

In many instances, the ICC has ignored or acted contrary to the directives of the Staggers Act, to the direct harm of coal producers and the shipping public they serve. Specific, major areas of ICC mismanagement should be of primary importance to the Congress and this Committee in formulating corrective action. They are:

(1) standards for determining railroad revenue adequacy;

(2) coal rate guidelines;

(3) exercise of the ICC's exemption authority;

(4) market dominance; and

(5) calculation of the railroad cost recovery index.

Congress is well aware of the problems captive coal receivers face. Because of the close interrelationship between shipper and producer, the transportation situation faced by coal receivers is shared by producers as well. One of the primary purposes behind the Staggers Act was to balance the necessity of protecting captive coal from monopoly pricing with the railroads' interest in greater pricing freedom where they compete with other forms of transportation. The ICC, however, has embarked on a course which unduly burdens captive coal shippers, and seems to have as its only goal increasing the profitability of the nation's railroads.

1. REVENUE ADEQUACY STANDARDS

a. The ICC's Policy

Section 205 of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act") required the ICC to promulgate standards and procedures for determining rail carrier revenue adequacy through the rulemaking process. The decision resulting from this rulemaking established a standard requiring the ICC to consider "all pertinent financial indicators" in deciding whether a rail carrier was revenue adequate.[1] Under this standard the ICC determined that thirteen of the nation's thirty-six Class I railroads were revenue adequate.[2]

The ICC used its determinations of revenue adequacy chiefly in complaint cases involving captive coal receivers, in which the ICC concluded that revenue inadequate carriers were entitled to higher rates. The railroads were unsatisfied by this, however, and tried to convince the ICC to premise carrier revenue adequacy solely on a single standard: whether a carrier was earning a current cost of capital return on its net investment base. Further, the railroads argued that a revenue inadequate carrier should be allowed to charge any rate it chose on captive traffic. The ICC flatly rejected the railroads' arguments.

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[1] Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Revenue Levels, 358 I.C.C. 844, modified, 359 I.C.C. 270 (1978).

[2] Ex Parte No. 353, Adequacy of Railroad Revenue (1978 Determination), 362 I.C.C. 198 (1979).

Snubbed by the ICC, the railroads sought Congressional legislation to overturn the ICC's decision. Congress, in the Staggers Act, refused the railroads' requests to modify the revenue adequacy definition of the Interstate Commerce Act. Congress did, however, codify the ICC's practice of considering a carrier's revenue adequacy in reasonableness determinations and rate suspension investigations. Revenue adequacy was also the predicate for deciding whether a carrier was entitled to the use of certain rate flexibility procedures introduced by the Staggers Act. The Staggers Act directed the ICC to make a carrier revenue adequacy determination within 180 days and thereafter on an annual basis.

The ICC responded to the command of the Staggers Act by instituting Ex Parte No. 393, Standards for Railroad Revenue Adequacy ("Ex Parte 393"). The final order in Ex Parte 393 replaced the previously used revenue adequacy standards with the same rate base/rate of return standard that both the ICC and the Congress had rejected in the past. Ex Parte 393 holds that a carrier is revenue adequate only if it earns a rate of return on its net investment base equal to the current cost of capital for the railroad industry as a whole.[3] No other indicia of financial health -- regardless of relevance or reliability -- are employed.

Under the Ex Parte 393 standard, not one major railroad in the nation is revenue adequate. In fact, an abyss exists between the railroads' present earnings and those deemed necessary to achieve revenue adequacy under the new standard. Ex Parte 393 also contains three methodological errors that improperly increase the sums that carriers need to be revenue adequate. First, under Ex Parte 393 carrier debt costs are calculated at the current cost of capital, in spite of the fact that much carrier debt was issued many years ago at interest rates far below those presently charged. Second, the ICC determined to allow deferred taxes to be included in the net investment base, though such monies, contributed to the carriers by ratepayers, is no-cost capital which clearly should be excluded if one is focusing on the amount of money a carrier needs to pay its expenses, debt service, and attract captial. Third, unused and nonuseful assets may be included in net investment bases under the ICC decision. By the carriers' own figures in Ex Parte 393, shippers are paying a rate of return on at least a quarter billion dollars' worth of property that the carriers do not use. Needless to say, these three errors vastly inflate the amount railroads need to reach the magic plateau of "revenue adequacy."

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[3] Ex Parte No. 393, Standards for Revenue Adequacy, 364 I.C.C. 803 (1981).

The ICC has also elevated revenue adequacy to be the sole factor it considers in determining the reasonableness of rates on captive coal traffic, in direct violation of Congress' intent. Congress mandated a balance of "the needs of carriers, shippers and the public" in setting coal rates. At present, for all practical purposes the ICC permits carriers to charge whatever rates they choose on coal traffic so long as the rates contribute to the goal of revenue adequacy,[4] and as a result has *de facto* deregulated coal rates to captive receivers. This is plainly not consistent with the balance Congress sought in enacting the Staggers Act.

b. The Railroads Are Financially Healthy

The ICC's contention that no major rail carrier is revenue adequate is shown to be particulary unrealistic when one examines the evaluations of the carriers' financial health provided by the financial press. Such articles refer, for example, to large amounts (in each case over a billion dollars) that Burlington Northern, CSX and Norfolk Southern have amassed for corporate acquisitions,[5] and contain glowing recommendations of the railroads' stocks to potential investors.[6] While the railroads often point to these reports as misleading -- they say the reports refer to their holding companies -- the fact is that in each case the holding company in question derives the lion's share of its capital from rail operations. The nation's coal hauling railroads, though not revenue adequate within the ICC definition, are healthy enough to make major corporate acquisitions at will and to be recommended as attractive investment possibilities. Something is clearly amiss.

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[4] *See, e.g.*, No. 38793, *Petition For Review of a Decision of the Public Service Commission of West Virginia Pursuant to 49 U.S.C. 11501* (Decision served March 13, 1982), *appeal docketed sub nom. Wheeling-Pittsburgh Steel Corp. v. United States*, No. 82-3122 (3rd Cir. March 25, 1982); No. 38946, *Petition of the Louisville and Nashville Railroad Company For Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501* (Decision served June 23, 1983), *appeal docketed sub nom. Public Service Commission of Indiana, Inc. v. ICC*, No. 83-1691 (D.C. Cir. June 24, 1983).

[5] *See Business Week*, March 8, 1982; *Wall Street Journal*, July 1, 1983; and *Forbes*, April 12, 1982.

In spite of the obvious gap between the ICC's view of revenue adequacy and reality, the ICC has shown no signs of changing its revenue adequacy standards. Congress must act to reaffirm its position that revenue adequacy determinations should be based on all relevant financial indicators, that ICC revenue adequacy determinations be more realistic, and that revenue adequacy be but one consideration in maximum rate determinations.

2. COAL RATE GUIDELINES

ICC policy on maximum reasonable rates for captive coal traffic -- traffic which has no alternative to rail service for transportation -- is one of the most critical issues facing this Subcommittee and the entire Congress. Under the ICC's present standards, coal shippers and receivers are left completely unprotected from the monopoly pricing practices of the railroads which control volume coal transportation.

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[6] See Trendline's Current Market Perspectives, April, 1983, p. 44; Value Line, April 8, 1983, p. 304; and Value Line, May 20, 1983, p. 1232.

a. The Search For A Formula

Before the Staggers Act, the ICC depended primarily on three criteria in evaluating maximum rate reasonableness: comparisons of the challenged rate with existing rates for comparable movements; the relationship between the rate and the service costs associated with the movement; and the public interest. After several years of gradually increasing its reliance on the cost-of-service standard, in 1979 the ICC settled on a cost-based formula known as the "seven percent solution."

The seven percent solution allowed carriers to recover fully allocated costs at the revenue need level, as well as a seven percent additive or cross-subsidy awarded to promote railroad revenue adequacy. The railroads argued that since they were forced by competition to charge less than their fully allocated costs on some movements, they must be allowed to charge more than fully allocated costs on captive traffic in order to earn an average return at the required revenue level. The ICC agreed, though it cautioned that railroads were not to look solely to captive coal traffic for recovery of their revenue needs.

The ICC adopted the seven percent solution as an interim approach pending a decision in Ex Parte No. 347, Western Coal Investigation, a proceeding designed to establish principles for determining reasonable rates on western unit train coal traffic.[7] The ICC's "interim" approach was struck down by the U.S. Court of Appeals for the D.C. Circuit, however,[8] on grounds that the ICC's decision "provide[d] no defensible rationale for the inclusion of the seven percent additive" and was therefore arbitrary and capricious. The Court did not rule out any increment over full costs, but stated that the ICC had to adequately justify such an increment. At the time the Staggers Act was enacted, the ICC's efforts to develop a comprehensive coal rate methodology floated in a state of suspended animation.

The Staggers Act retained the pre-existing standard for rail rates on market dominant traffic: i.e., that all such rates be "reasonable." Congress was especially concerned, however, over the fate of captive shippers -- particularly coal shippers. The legislative history of the Staggers Act is replete with references to the need to place effective constraints on captive coal rates.[9]

The Staggers Act also inserted provisions into the law itself designed to safeguard against rail cross-subsidization and supra-competitive pricing at the expense of coal traffic. The "Long-Cannon Amendments"[10] are an attempt to balance protection for captive shippers with the flexibility given railroads in pricing market dominant traffic. The Amendments make clear that captive traffic cannot be forced to bear a disproportionate burden of the costs of carrier revenue adequacy.

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[7] 43 Fed. Reg. 22151 (May 23, 1978).

[8] San Antonio, Texas v. United States, 631 F.2d 831, 851 (D.C. Cir. 1980).

[9] See, e.g., S. Rep. No. 96-470, 96th Cong. 1st Sess. 7,8 (1979); H.R. Rep. No. 96-1430, 96th Cong. 2d Sess. 80 (1980).

[10] See 49 U.S.C. § 10707a(e)(2)(C).

Shortly after the Staggers Act was enacted, the ICC proposed new maximum rate guidelines for coal transportation in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines -- Nationwide. These guidelines proposed a formula based on the variable cost of service, a share of fixed costs determined on the ton/ton-mile method of allocation, and a return on investment equal to the current cost of capital. The railroads responded to this formula by proposing that the ICC permit them to price their traffic as they see fit until they reach revenue adequacy. In effect, they advocated that they be allowed to charge "what the traffic will bear." In December, 1981, the ICC rejected the guidelines it had proposed in Ex Parte No. 347 (Sub-No. 1) and requested further comments on the type of standard it should adopt, and between December, 1981 and February, 1983 there was an unofficial moratorium on ICC decisionmaking on maximum rates for coal traffic.

b. Open Season On Captive Coal

On February 24, 1983 the ICC proposed an entirely new methodology for evaluating captive coal rates. The new formula is being sold by the ICC as a "matrix," under which any captive coal rate (or increase) by a revenue inadequate carrier would be deemed reasonable, unless it ran afoul of one or more of the following constraints:

(1) a rate may not exceed the "stand-alone" costs of service associated with the movement;

(2) a rate may not impose on a shipper avoidable costs arising from management inefficiencies;

(3) a rate may not be raised by more than 15% per year (after inflation); and

(4) once a carrier achieves revenue adequacy within the ICC definition, its ratemaking flexibility would be subject to tighter constraint.

The new methodology, which the Commission has already stated will apply in all pending cases, may well prove to be disastrous to the struggle for balanced rail rate regulation and the protection of captive coal shippers and producers. The constraints the ICC proposes are not constraints at all.

The stand-alone "constraint" effectively caps rates at a level equal to the shipper's cost of acquiring and operating its own rail line. In one recent case,[11] a rail carrier has calculated that the "stand-alone" cap on its movement to an Eastern utility would allow rates of approximately $182.00 per ton, about 1400% higher than the current rate.

The "managerial inefficiency" constraint is without teeth. The ICC has enunciated no standard for measuring efficiency, nor does it possess a proper data base. It is claimed by the ICC that this constraint incorporates the Long-Cannon Amendment into ratemaking, but the Commission has shown no intention of requiring carriers to divulge the information necessary to address managerial efficiency -- information they alone possess.

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[11] Docket No. 37872, Potomac Electric Power Co. v. Baltimore & Ohio Railroad Co. et al.

The third "constraint" allows any rate to increase by 15% per year, after inflation. In so doing the ICC has almost tripled the 6% figure set by Congress (49 U.S.C. § 10707a(c)) as the upper limit of rate flexibility available to rail carriers without fear of ICC scrutiny. According to the ICC, 15% per year increases on coal traffic alone will ensure that the rail industry achieves revenue adequacy within 7 to 9 years -- the time the ICC predicts that coal slurry pipelines will be available. In blatant disregard of Congressional intent, the ICC is encouraging railroads to look to a single captive commodity to recover their entire alleged revenue shortfall.

The fourth constraint is meaningless at this time, because the ICC has given no indication of how its rate evaluation would change once a carrier became revenue adequate.

In sharp contrast to the zeal with which the ICC pursues increased rate flexibility in the name of railroad revenue adequacy, the Long-Cannon criteria -- enacted out of Congressional concern for captive coal shippers -- have been virtually ignored in the 33 months since their passage. The Long-Cannon criteria require consideration of the amount of non-compensatory traffic hauled by a carrier, the extent to which a carrier maximizes its marginal traffic revenues, the mix of a carrier's traffic, and whether particular segments of traffic are required to pay an unreasonable share of overall revenues, in assessing the reasonableness of a carrier's rates.

The ICC has effectively robbed the Long-Cannon criteria of any meaning by placing the burden of presenting evidence relative to the criteria on shippers, while refusing to require railroads to divulge the information necessary to address the criteria. Gutting the Long-Cannon criteria has rendered nugatory the Congressional effort to balance carrier rate freedom with captive shipper protection.

3. ICC EXERCISE OF EXEMPTION AUTHORITY

Of all the examples of the ICC's administrative emasculation of the protections for captive coal shippers and producers intended by Congress in the Staggers Act, perhaps the most disastrous from the perspective of the small Eastern coal producer took place in March of this year, when the ICC announced its decision to remove all aspects of ICC regulation from the inland transportation of export coal by rail. This far-reaching action, taken in Ex Parte No. 346 (Sub-No. 7), Exemption From Regulation -- Export Coal, eliminated all ICC jurisdiction over pricing practices, common carrier obligations, and non-discriminatory practice questions related to the transportation of coal exports.

Under the Staggers Act, the ICC is empowered to grant exemptions from regulation only when it finds that an exemption would be consistent with national transportation policy and (1) would be limited in scope or (2) would not expose shippers to abuse of rail market power. In the case of export coal, the Commission purported to find that continued regulation was not necesssary to protect coal producers and shippers from rail market power abuse, notwithstanding the undisputed fact that over 90% of the mines producing coal for export are wholly captive to a single rail line for access to essential export terminal facilities.

The ability of a party to protect itself from abuse of market power in the absence of regulation depends wholly on the relative market strength of that party vis-a-vis those with whom it does business. Large shippers or coal producers whose facilities are served by more than one railroad are few; the vast majority of export coal producers are small to medium-sized companies, and many are concentrated in the Eastern Appalachian coal fields. Because of their small size, these producers have virtually no leverage in dealing with the two railroads (CSX and Norfolk Southern) which together dominate the export coal transportation market. Under the ICC's exemption, these carriers will be free to dictate any rates they choose to export coal shippers. They will be under no obligation to restrain from imposing discriminatory rates on those shipments moving to river points for further transportation by barge, and in those instances where a particular coal producer's traffic does not offer an attractive enough revenue picture the carrier will be free to refuse to provide service altogether. Additionally, by removing export coal from the prohibitions of the so-called commodities clause, the ICC's decision will enable Eastern rail carriers to mine coals from their own properties, transport it over their own rail lines, transship it through their own coal export terminals, and -- if recent news reports are to be believed -- load it onto their own ocean vessels. Such vertical integration could clearly mean the end of the small producer's participation in the export coal trade. The result (aside from increased rail profits) would be increased unemployment, an acceleration in small business failures, an anti-competitive concentration of market power in the hands of a few large producers, and a steady decline in America's position as a supplier of quality steam and metallurgical coal.

Through its decision in Ex Parte 346 (Sub-No. 7), the ICC has administratively deregulated the quintessential captive commodity -- coal -- in direct contravention of Congressional intent.

4. MARKET DOMINANCE

The concept of market dominance was established in Section 202 of the 4-R Act. Under the Act, "market dominance" was defined as:

> an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies.

The 4-R Act required that the ICC promulgate, by rule, standards and procedures that would facilitate practical determinations of market dominance.[12]

Congress adopted the market dominance test, as explained in the Conference Report, "to permit rates to be set by the forces of competition in those situations in which effective competition exists."[13] In addition, the history of the 4-R Act indicates that Congress intended that the ICC's market dominance rules "be designed to provide for a practical determination without administrative delay." On October 1, 1976, the ICC issued its decision in Ex Parte No. 320, _Special Procedures For Making Findings of Market Dominance As Required by the Railroad Revitalization and Regulatory Reform Act of 1976_,[14] and promulgated the rules required by the 4-R Act. Under the rules, a finding of market dominance could be triggered by a shipper's showing that the circumstances surrounding its transportation arrangements fit one or more "presumptions" (_e.g._, rate/cost ratio, market share, shipper investment in carrier equipment).

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[12] Pub. L. No. 94-210, § 202(b) 90 Stat. 31 (1976).

The ICC also established specific procedures for considering issues of market dominance.[15] Finally, the ICC reaffirmed its earlier finding that the statutory definition of market dominance and Congress' intent regarding application of the concept limited the scope of consideration to direct transportation competition for the traffic or movement in question.[16]

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[13] S. Rep. No. 94-595, 94th Cong. 2d Sess. 148 (1976).

[14] 355 I.C.C. 12 (1976).

[15] These procedures set forth in specific and mandatory terms the evidence which parties were to present, the form such evidence should take and where it was to be presented. _See_ 355 I.C.C. at 22-23.

[16] The Commission's Final Order in _Ex Parte No. 320_ was upheld by the United States Court of Appeals for the District of Columbia Circuit in _Atchison, Topeka & Santa Fe Railway Co. v. ICC_, 580 F.2d 623 (D.C. Cir. 1978).

Since passage of the Staggers Act, the Commission has scrapped its prior market dominance rules and substituted a long list of "evidentiary criteria," which it calls "guidelines for submitting evidence." These guidelines were developed in Ex Parte No. 320 (Sub-No. 2), and were allegedly based upon the "intent" of the Staggers Act, although the Staggers Act specifically left the definition of market dominance unchanged. The guidelines (which are in effect today) are divided into four categories: intramodal competition, intermodal competition, geographic competition, and product competition. Thirty criteria are listed under these four headings. Simultaneously with its order in Ex Parte No. 320 (Sub-No. 2), the ICC issued an order in Ex Parte No. 320 revoking the existing market dominance regulations -- a radical repudiation of the procedures developed under the 4-R Act.

The Commission's current position on geographic and product competition is inconsistent with the statutory directive that the market dominance standard be a practical, threshold test. The ICC itself recognized that:

> determining whether [geographic and product competition] have a significant impact in a particular case would require anti-trust type litigation, as the interplay which affects competition for the sale of a product and competition for transportation services is very complex.

Ex Parte No. 320, 353 I.C.C. at 905.

The manifest purpose of the market dominance concept was to facilitate an early determination of the existence of competition for the traffic that is subject to a challenged rate --

and thereby determine ICC jurisdiction over that rate. The ICC's authority to promulgate rules was an integral part of Section 202 of the 4-R Act, and was counted upon to guard against protracted, complex market dominance proceedings.

There is no doubt that the Ex Parte No. 320 rules and procedures achieved the result contemplated by the 4-R Act. This was recognized by the D.C. Circuit in Atchison, T. & S.F. Ry. Co. v. U.S. However, in its decision in Ex Parte No. 320 (Sub-No. 2) the ICC completely abdicated the responsibility placed upon it by Congress in the 4-R Act. Market evaluations by the ICC under its Ex Parte No. 320 (Sub-No. 2) guidelines involve complex issues of antitrust law which the ICC is neither designed nor staffed to resolve, and which Congress never intended to be a part of the market dominance determination.

In a decision issued in December, 1982, a panel of the U.S. Court of Appeals for the Fifth Circuit ruled that the ICC's inclusion of potential geographic and product competition in analyses of carrier market dominance "violates the limits contained in the statutory definition and is invalid."[17] If the panel's decision on these matters is affirmed, Congressional action will still be needed in order to address the ICC's "laundry list" approach to market dominance findings. If the panel's decision is reversed, however, immediate legislative action would be crucial to the preservation of shipper access to the ICC for adjudication of maximum reasonable rate disputes.

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[17] Western Coal Traffic League v. U.S., 694 F.2d 378 (5th Cir. 1982) (ECTC participated in this case as amicus curiae).

5. RAILROAD COST RECOVERY INDEX

Section 203 of the Staggers Act allows carriers to take quarterly freight rate increases according to an index of railroad costs -- the rail cost adjustment factor. These increases are totally immune from shipper challenge. The ICC uses an index compiled by the AAR called the "Index of Railroad Material Prices and Wage Rates," an index which measures the prices the railroads pay for purchased materials and wages. It is an index of input prices, unadjusted for changes in productivity and traffic volume. The Index, as a result, overstates the rate increases needed to yield additional revenues sufficient to cover cost increases.

The failure of the ICC's rail cost adjustment methodology to adjust the AAR Index for productivity changes was challenged by shippers immediately after its announcement in Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures.[18] The court affirmed the ICC decision,[19] though it agreed with shippers that in Section 203 Congress meant only to allow recovery of costs, not the enhancement of revenue. The Court stressed that it expected the ICC to revise its Index, including consideration of a productivity adjustment, as circumstances might warrant.[20]

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[18] 364 I.C.C. 841 (1981).

[19] Western Coal Traffic League v. United States, 677 F.2d 915 (D.C. Cir. 1982).

[20] Id., at 931.

The legislative history and language of Section 203, now codified at 49 U.S.C. § 10707a(a)(2)(B) support beyond question the D.C. Circuit's conclusion that the cost recovery index is meant to allow unquestioned rate increases only to neutralize the effects of inflation. The Section itself states, in pertinent part:

> Commencing with the fourth quarter of 1980, the Commission shall ... publish a rail cost adjustment factor ... with appropriate adjustments to reflect the changing composition of railroad costs, including the quantity and mix of materials and labor ....

The legislative history also demonstrates that Congress specifically intended the ICC to use output costs (rather than input prices) in the Cost Recovery Index.[21] The ICC's continued use of the unadjusted AAR Index is in blatant disregard of Congress' directive that the cost recovery index be used solely to reduce "the time lag involved in recovering cost increases."[22]

The ICC did begin a proceeding designed to solicit suggestions on the development of certain productivity adjustments to the AAR Index.[23] However, the Commission's progress in this area has been anything but swift. The advanced notice of rulemaking was served one year ago, comments were filed in October, 1982 and yet the ICC has still not proposed a productivity adjustment mechanism. While the ICC may be complying with the letter of the D.C. Circuit's admonition, the spirit of the Court's directive is being ignored. There is no excuse for the ICC's foot-dragging in this area, though it seems nothing short of a mandate from Congress would suffice to prompt the Commission into positive action.

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[21] S. 1946, 96th Cong. 1st Sess. at 103 (1979), S. Rep. No. 96-470, 96th Cong., 1st Sess. at 52 (1979) ("Senate Report").

[21] Senate Report, at 19.

[23] Ex Parte No. 290 (Sub-No. 4).

6. A LEGISLATIVE RESPONSE

Two bills, S. 1082 (introduced by Sen. Ford) and H.R. 2584 (introduced by Rep. Rahall) would address many of the serious problems resulting from the ICC's one-dimensional view of the Staggers Act. In particular, these bills would:

(1) make it clear that railroads have the burden of going forward with evidence responsive to the Long-Cannon criteria, and that although revenue adequacy is an important consideration in maximum rate determinations, the Commission must also take into account a number of other important factors;

(2) ensure that the ICC takes into consideration a variety of widely-utilized indicators of financial health in determining carrier revenue adequacy, and ensure that the railroads' net investment base would not include such no-cost items as deferred taxes and unused or nonuseful assets;

(3) require the ICC to consider changes in railroad productivity in developing its quarterly inflation index;

(4) codify the market share and substantial investment presumptions which were contained in the Commission's pre-Staggers Act market dominance regulations, and preclude the ICC from considerating potential geographic and product competition in making market dominance determinations; and

(5) prohibit the ICC from granting an exemption from regulation in connection with captive rail traffic, such as coal and other bulk commodities.

The Eastern Coal Transportation Conference supports H.R. 2584 and S.1082. As these and other bills which may be introduced dealing with these issues are considered by the Congress, ECTC would also support amendments or new provisions which would deal more definitively with the standards to be applied by the Interstate Commerce Commission in determining maximum rate reasonableness.

EASTERN COAL TRANSPORTATION CONFERENCE

Amherst Industries, Inc.
Charleston, WV

ANR Coal Company
Roanoke, VA

Armco Material Resource
Richmond, VA

A.T. Massey Coal Company
Richmond, VA

Berwind Corporation
Philadelphia, PA

Blue Diamond Coal Company
Knoxville, TN

Cannelton Industries, Inc.
Charleston, WV

Carbopn Fuel Sales Company
Charleston, WV

Cyprus Coal Company
Englewood, CO

Diamond Shamrock Coal Unit
Lexington, KY

Electric Fuels Corporation
St. Petersburg, FL

Elk River Resources
Knoxville, TN

Inspiration Coal, Inc.
Knoxville, TN

Kessler Coals Co., Inc.
Charleston, WV

Land Use Corporation
Summerville, WV

Logan & Kanawha Coal Company
Cincinnati, OH

Old Ben Coal Company
Chicago, IL

Perry & Hylton
Beckley, WV

Pickands Mather & Company
Cleveland, OH

Pratt Mining Company
Hansford, WV

Slab Fork Coal Company
Slab Fork, WV

South East Coal Company
Irvine, KY

STATEMENT OF
JAMES C. ROONEY
ASSOCIATE ADMINISTRATOR FOR POLICY
FEDERAL RAILROAD ADMINISTRATION
BEFORE THE SENATE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
COMMITTEE ON ENERGY AND NATURAL RESOURCES
NOVEMBER 15, 1983

I appreciate the opportunity to present the position of the Department of Transportation on issues affecting America's coal industry, particularly as they relate to railroads and railroad regulation.

The Department believes that our transportation policies and our energy and economic policies are and must continue to be consistent--that a healthy, smoothly functioning transportation sector is vital to healthy and successful energy and industrial sectors, and on the other hand, that healthy energy and industrial sectors are vital for our carriers to continue to survive and provide effective service.

We are monitoring the experiences of carriers and shippers as regulatory reforms in the transportation sector are being implemented, with particular attention to bulk commodities, including coal. The principal purpose of the Staggers Act was to reduce or eliminate the burdens on commerce imposed by regulation and to permit competitive forces to work wherever possible for the benefit of railroads and shippers. Combined with the subsequent actions by the ICC to implement the legislation, the Staggers Act has allowed railroads to respond to shippers' needs and market conditions by adjusting rates and tailoring services to attract and retain traffic. Shippers' transportation options have increased, and many railroads have reduced rates or offered new types of service to meet competition, balance traffic flows, and hold or boost market share.

Railroads have been particularly active in negotiating rate and service contracts which were explicitly authorized by the Staggers Act, and these contract arrangements benefit both railroads and shippers. In September 1982, fewer than 2,000 contracts had been filed with the ICC; now, one year later, there are over 10,000 contracts on file. Contract terms include volume incentives, guaranteed car supply or other special services, covering one shipment or periods as long as 20 years or more.

In those commodity areas already exempt from regulation, the railroads have moved aggressively to build traffic. Railroads' piggyback business, the major service exempted since the Staggers Act was passed, has grown to record levels. Despite a reduction in overall rail traffic between 1981 and 1982, piggyback carloadings rose significantly.

In most markets, railroads have had to increase their rates to reflect increases in the prices they pay for fuel, materials, and labor. Rail carriers have also found it necessary to raise rates to obtain the funds required to modernize or upgrade their facilities and equipment. In the years since the Staggers Act was passed, rail tariff rates for unit train coal movements in the West have gone up more quickly than in the East and more quickly than rail rates in general. However, these figures do not cover rates established as part of long-term contracts negotiated between shippers and railroads, which often incorporate rate reductions. Our most recent statistics indicate that in 1981 coal rates nationwide averaged only 2.5 cents per ton-mile hauled--the lowest for any major commodity group. Western rates per ton-mile were even lower.

One of the Staggers Act changes with the most major impact on the industry and its shippers is the expansion of the ICC's power to exempt railroad traffic from regulation. The Commission can now approve an exemption if it determines that regulation is not necessary to carry out rail transportation policy and either the service is of limited scope or continued regulation is not needed to protect shippers from the abuse of market power. Effective September 12, 1983, the Commission exempted export coal moved by rail to U.S. ports.

DOT supports the exemption of export coal, and filed extensive comments with the ICC in the proceeding. We believe that there is ample competition in the export market. One of the most important forces in constraining rail rates for export coal is the power of the other parties in the export coal process. Our research indicates that the concentration of export coal traffic among relatively few railroads is effectively countered by the concentration of export coal business in the hands of a small group of exporters or "transshippers." These large firms generally own mines or contract with mines on more than one railroad and therefore control the volume of coal available for any railroad to carry to export. The exporting firms in some cases are also major shippers of coal to domestic customers, which gives them additional bargaining power with a railroad.

The Chessie System (part of CSX) and the Norfolk and Western (part of Norfolk Southern)--two major railroads carrying export coal from the Appalachians--reported that in 1981, when participation in the export coal market was more fragmented than it is today, the eight largest exporters accounted for two thirds of the coal exports shipped via the Chessie System and over 80 percent of the coal exports shipped via the Norfolk and Western. The volume of traffic they represent gives these exporters the considerable leverage in negotiating rates with the railroads. Failure of any railroad to deal constructively with any of the larger exporters could mean a significant diversion of traffic and loss of revenues, which would be particularly serious for these railroads, which have high fixed costs for rail lines and other facilities devoted almost exclusively to export coal movements.

The coal-exporting railroads have invested billions of dollars in tracks, bridges, tunnels, yards, and pier facilities as well as rolling stock, in order to get coal from the mines into the holds of ships, and all of these investments result in high fixed costs for the railroads.

Sound business principles dictate that a railroad price its transportation services to maximize the payback on those investments. A railroad would only hurt itself by raising rates indiscriminately, in the face of competition from other railroads and the producers they serve, as well as intense competition for U.S. coal from overseas suppliers. Such a strategy would reduce the volume of export coal shipped by the railroad and its ability to cover fixed costs.

Based on these factors, the Department of Transportation believes that there is sufficient competition in the export coal market that ICC regulation is not required to protect shippers and that the exemption of this traffic from regulation is entirely consistent with the national transportation policy. These are the statutory criteria that the ICC must apply in determining whether to exempt a particular portion of railroad traffic from regulation. The Department of Justice, representing the United States, has also determined that the ICC fulfilled its statutory obligations in granting the exemption and, therefore, has joined with the ICC in supporting the legality of the exemption in litigation before the U.S. Court of Appeals for the D.C. Circuit.

Experience during the past two years supports the position that competition can be relied upon to restrain rates on export coal movements. Several railroads have recently offered attractive contract terms or reductions in tariff rates for export coal, in response to market circumstances and shippers' needs. In addition, railroads have not taken any of the rate increases above inflation which the Staggers Act would have allowed on this traffic, nor did they apply the two most recent ICC approved inflation-based increases to export coal traffic.

For domestic coal, the ICC has proposed new guidelines to use in regulating rates for traffic over which a railroad has market dominance. These guidelines are based on the principle that no shipper should pay more than stand-alone costs, a proposition on which the ICC has found considerable agreement among the parties participating in this proceeding. We generally support the ICC's proposal, with several specific qualifications. I will summarize our position for you.

The Department concurs with the ICC and all other parties that a railroad should not set rates such that coal shippers have to make up for revenue shortfalls the railroad suffers as a result of other rates that do not contribute to going concern value or otherwise do not generate the maximum net revenues for the railroad. The Department also agrees that a coal shipper should not be required to cross-subsidize other shippers, by paying for facilities and operations that are not necessary for the railroad to serve that shipper.

We wish to see the Commission establish a single, clear definition of stand-alone costs, focusing on those items necessary for a railroad to offer the service in question. Estimates of stand-alone costs must cover the full annualized costs of equipment and facilities, as well as operations and management and other overhead that would be incurred to provide the service. We support the ICC's recommendation that stand-alone rates be phased in gradually, but we believe that the allowable 15 percent per year increases should not be cumulated when a railroad does not take the full increase in a particular year. For railroads that achieve revenue adequacy, however, we see no reason why earning more than the minimum revenues considered necessary by the ICC should be grounds for requiring a railroad to reduce its existing rates.

I believe that, with the modifications the Department has proposed, the ICC's regulation of domestic coal rates will be responsive to the needs of the affected parties and the requirements of the Staggers Act.

Santa Fe Industries, Inc.

November 7, 1983

The Honorable John W. Warner
Chairman, Subcommittee on Energy
and Mineral Resources
United States Senate
Washington, D.C. 20510

Dear Senator Warner:

I was pleased to receive your letter of Oct. 27, 1983, informing me of the oversight hearing to be held Nov. 15 by your Subcommittee on Energy and Mineral Resources on the condition of America's coal industry.

While Santa Fe Railway has not historically been associated with the mass movement of coal, coal traffic has been and will continue to be extremely important to us as our participation in the movement of this commodity increases.

Although I am unable to accept your kind invitation to appear before your subcommittee on Nov. 15, I suggest that it may be beneficial to you and your colleagues and staff to have the benefit of Santa Fe's thinking on perhaps some of the areas to be addressed in your forthcoming deliberations.

To accomplish this purpose, I have requested Mr. Tom McKnew, Vice President of Santa Fe Industries in Washington, to provide you with material relating to the Santa Fe's coal traffic in general and to the subject of export coal in particular.

I apologize for not being able to be present at your oversight hearing but hope that the material which will be provided will be of benefit.

Thank you for your consideration.

Sincerely yours,

John J. Schmidt

John J. Schmidt
Chairman and
Chief Executive Officer

✓blind note: Roger Sindelar, Esq. - Original letter and attachments hand-delivered
to Senate Warner's office.

BEFORE THE

INTERSTATE COMMERCE COMMISSION

RAILROAD EXEMPTION - EXPORT COAL	)	Ex Parte 346 (Sub. No. 7)

VERIFIED STATEMENT
OF
KERN E. MEDLEY

I am Kern E. Medley, Manager-Fuels Traffic Development of The Atchison, Topeka and Santa Fe Railway Company (Santa Fe). I joined Santa Fe in 1947, in the Operating Department. I have held various positions in the Operating Department Cost Analysis and, Accounting Departments, as well as in the Market Development and Research and Pricing sections of the Traffic Department.

In 1973 I assumed the position of Assistant Manager Pricing in the fuel traffic development area and was named to my present position in 1975. I am responsible for the development of rates for prospective high volume coal movements, and participate directly in negotiations with potential customers. I have over 23 years experience in railroad pricing.

The purpose of my statement is to describe briefly Santa Fe's present involvement in the movement of export coal, our expectations for the future in this market, and why Santa Fe believes the continued regulation of export coal by the Interstate Commerce Commission is not necessary under the national transportation policy, is not needed to protect shippers from an abuse of market power. In our view, exemption of export coal from regulation would promote the growth of such traffic from its presently limited scope on the Santa Fe.

Coal traffic has been and will continue to be enormously important to the Santa Fe. Our coal traffic has grown from approximately 5 million tons in 1976, reflecting only 3.6% of total carloadings, to 21.2 million tons in 1980 and an estimated 25 million tons in 1981, representing approximately 15.4 percent of our total carloadings. However, these movements have been almost entirely to serve the domestic United States market. Through 1980, we handled no measurable tonnage for the export market. In 1981, we have handled 200,000 tons of export coal, which represents only eight tenths of 1% of our total coal traffic in 1980, and only a miniscule portion of our total traffic.

While our current involvement in this traffic is very minor, comprising small movements ultimately destined to the Far East, we look to the future to bring substantial growth in this area, particularly with respect to the movement of western coal for export to the Pacific Rim countries as a substitute for oil. At present such potential customers have expressed the most interest in coal of specific quality that predominates in Utah, Wyoming and Colorado. I believe that as that coal becomes committed in world markets, New Mexico coal, with many desirable qualities but of somewhat lower BTU content, will become a greater factor in these markets.

This is a highly competitive market, with coal that could be shipped over the Santa Fe competing with coal from other countries, particularly Australia and South Africa, and with coal originating at mine areas served by different western railroads.

In this environment, Santa Fe believes exemption from regulation would foster the growth of export coal movements by giving us greater flexibility to price coal for movement into the export market. Contractual arrangements for export movements could be made without regard to their possible impact on domestic rate relationships.

Because of the wide variety of potential export markets, prospective movements are bid on a highly individual basis without the patterns of rate relationships that normally accompany common carrier service and published tariffs. Even though we now have the ability to enter into railroad transportation contracts, they must be entered into within a regulatory framework which constrains negotiations based on sound, mutually recognized economic principles. In the area of coal transportation, for example, I believe shippers have been reluctant to make contracts as a result of the Commission's proposal in Ex Parte 347 (Sub. No. 1), proposals that in my view are not economically sound. It has been my experience that in a climate of rigid regulatory standards, there is far less incentive for parties to enter into contracts than in the unregulated marketplace. If we are to be in a position to make our best long-term quote to move coal into the export market, we can best do so in an unregulated businesslike atmosphere, where our commitment can be accepted without prejudice to regulated traffic.

Santa Fe has found that high volume coal shippers require a high standard of customized service, which requires intensive levels of planning and investment in rail facilities. We believe the need for this planning will be particularly great in undertaking the long-term commitments necessary to make western coal a significant factor in the export markets. We believe that growth and planning can best occur in the absence of regulatory restraints.

VERIFICATION

KERN E. MEDLEY, being duly sworn deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

Kern E. Medley

Subscribed and sworn to
before me this 17th day
of December, 1981.

Notary Public

AFFIDAVIT OF
KERN E. MEDLEY

STATE OF ILLINOIS)
) SS
COUNTY OF COOK)

I, Kern E. Medley, depose and state:

I am employed by The Atchison, Topeka and Santa Fe Railway Company (Santa Fe) as Manager-Fuels Traffic Development. I joined Santa Fe in 1947 in the Operating Department. I have held various positions in the Operating Department, Cost Analysis and Accounting Departments, as well as in the Market Development and Research and Pricing sections of the Traffic Department.

In 1973 I assumed the position of Assistant Manager Pricing in the fuel traffic development area and was named to my present position in 1975. I am responsible for the development of rates for prospective high volume coal movements, and participate directly in negotiations with potential customers. I have over 25 years experience in railroad pricing.

The purpose of my statement is to explain why the exemption of export coal should be permitted to go into effect as soon as possible, both to encourage long term and short term movements of export coal.

Santa Fe currently handles a very small amount of export coal traffic; comprising small movements ultimately destined to the Far East. We look, however, to the future to bring substantial growth in this area, particularly with respect to the movement of western coal for export to the Pacific Rim countries as a substitute for oil as well as metallurgical coal for steelmaking purposes. At present such potential customers have expressed the most interest in coal of specific quality that predominates in Utah, Wyoming and Colorado. I believe that as that coal becomes committed in world markets, New Mexico coal, with many desirable qualities but of somewhat lower BTU content, will become a greater factor in these markets.

Coal that could be shipped over the Santa Fe competes with coal from other countries, particularly Australia and South Africa, and with coal originating at mine areas served by different western railroads. In this highly competitive environment, Santa Fe believes exemption from regulation would foster the growth of export coal movements by giving us greater flexibility to price coal for movement into the export market. Contractual arrangements for export movements could be made without regard to their possible impact on domestic rate relationships.

Because of the wide variety of potential export markets, prospective movements are bid on a highly individual basis without the patterns of rate relationships that normally accompany common carrier service and published tariffs. Even though we now have the ability to enter into railroad transportation contracts, they must be entered into within a regulatory framework which hinders negotiations based on sound, mutually recognized economic principles.

In the area of coal transportation, for example, I believe shippers have been reluctant to make contracts as a result of the lack of finality of economically sound standards by the Interstate Commerce Commission. It has been my experience that in a climate of rigid or uncertain regulatory standards, there is far less incentive for parties to enter into contracts than in the unregulated marketplace. If we are to be in a position to make our best long-term quote to move coal into the export market, we can best do so in an unregulated businesslike atmosphere, where our commitment can be accepted without prejudice to regulated traffic.

Santa Fe has found that high volume coal shippers require a high standard of customized service, which requires intensive levels of planning and investment in rail facilities. We believe the need for this planning will be particularly great in undertaking the long-term commitments necessary to make western coal a significant factor in the export markets. We believe that growth and planning can best occur in the absence of regulatory restraints. That growth cannot fully commence until the exemption becomes effective.

In the short term, the exemption would be even more important to the encouragement of export coal movements. The market for export coal is presently very poor, and we need maximum flexibility to be able to make every effort to offer whatever price service package, for whatever term, can meet a shippers needs on immediate notice, without the possibility of regulatory hurdles or constraints.

Kern E. Medley
KERN E. MEDLEY

SUBSCRIBED AND SWORN TO
before me this 15th day
of August, 1983.

Rose L. Olsar
NOTARY PUBLIC

ROSE L. OLSAR
Notary Public for the State
of Illinois, County of Cook

My Commission Expires Jan. 24, 1987

RAILROAD COMMISSION OF TEXAS
P.O. DRAWER 12967
AUSTIN, TEXAS 78711

MACK WALLACE
CHAIRMAN

November 10, 1983

The Honorable John Warner, Chairman
Subcommittee on Energy and Mineral
Resources of the Committee on
Energy and Natural Resources
United States Senate
SD-308 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Warner:

The Railroad Commission of Texas hereby submits an original and three copies of its comments on the Staggers Rail Act of 1980 to the Subcommittee on Energy and Mineral Resources of the Committee on Energy and Natural Resources. If I can answer any questions or be of other assistance, please contact me.

Sincerely,

Mack Wallace

MACK WALLACE

MW/dp

Enclosure

BEFORE THE
UNITED STATES SENATE
SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
OF THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES

COMMENTS
OF
THE RAILROAD COMMISSION OF TEXAS

on

THE STAGGERS RAIL ACT OF 1980

Mack Wallace, Chairman
Buddy Temple, Commissioner
James E. (Jim) Nugent, Commissioner

Railroad Commission of Texas
P. O. Box 12967
Capitol Station
Austin, Texas 78711

COMMENTS OF THE
RAILROAD COMMISSION OF TEXAS
ON
THE STAGGERS RAIL ACT OF 1980

INTRODUCTION

The Interstate Commerce Commission has failed to administer the Staggers Rail Act of 1980 in accordance with its express provisions and the intent of Congress.

Congress committed regulators to an active role in maintaining competition while limiting government intervention in the rate setting process to instances where effective market place competition does not exist. These two facts of the National Transportation Policy declared by Congress are as two sides of the same coin. They cannot be separated. Nevertheless, the Interstate Commerce Commission (ICC) has pursued the policy of limiting government intervention without taking any steps to preserve competition as a surrogate for regulation.

The Railroad Commission of Texas (Railroad Commission) is gravely concerned over the behavior of the ICC and its total lack of concern with the furtherance of the intent of Congress embodied in the Staggers Act. The Staggers Rail Act of 1980 (the

Staggers Act) was intended as a compromise between competing economic interests. It has turned out to be a compromise of essential public interests and a betrayal of assurances given during its consideration before Congress.

The Railroad Commission offers the following comments and recommendations for change in specific provisions of the Staggers Act.

I. JOINT ROUTE CLOSINGS AND ABSORPTION OF RECIPROCAL SWITCHING CHARGES

A massive effort is under way among the railroads to capture previously competitive traffic that originates on their respective lines, both by closing joint routes and by refusing to absorb reciprocal switching charges.

In the area of rail rates, where primary reliance is on competition to protect the shipping public, the need to promote competition through maintenance of joint rates and routes and open reciprocal switching is greater than ever.

Congress foresaw that the railroads' newfound freedom could degenerate into anti-competitive behavior. 49 U.S.C. §10101a (Section 101 of the Staggers Act) commits the government to alleviating that danger by making it the National Transportation Policy to:

> "insure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes...to foster sound economic conditions in transportation and to insure effective competition and coordination between rail carriers and other modes..." (emphasis added)

In amending 49 U.S.C. §11103, Congress also strengthened the power of government regulators to combat the anti-competitive effects of predatory switching charge absorption practices. The law now reads:

> "The Commission may require rail carriers to enter into reciprocal switching agreements...where such agreements are necessary to provide competitive rail service. The carriers...shall establish the conditions and compensation applicable to such agreement, but, if the carriers cannot agree...the Commission may establish such conditions and compensation."

Ignoring the provisions in the statute, the ICC has nevertheless failed to curb the railroads' efforts to reduce competition and capture traffic by closing joint routes and refusing to absorb reciprocal switching charges. The ICC has taken no action, either on its own motion or on complaint by a member of the public, to "insure effective competition". On June 27, 1983, the ICC declined a request by the National Industrial Traffic League to even initiate a rulemaking proceeding to even consider prohibiting anti-competitive cancellations of joint rates and implementing the pro-competitive provisions of the Staggers Act regarding reciprocal switching.

II. CONTRACT RATE TARIFFS

A major area of concern to the Railroad Commission involves the ICC's actions with regard to contract rate tariffs.

49 U.S.C. §10713(b), enacted as Section 208 of the Act, requires that "all essential terms of the contract" be "made available to the general public in tariff format." The term "tariff" has been used for 50 years to describe a document containing a carrier's rates and related provisions.

ICC rules adopted October 8, 1982 under Ex Parte No. 387, Railroad Transportation Contracts, redefine the term "essential terms of the contract" so as to require disclosure only of the names of participating carriers, the commodities to be transported, the duration of the contract, certain rail car data, and the existence of special provisions such as discounts, allowances, or escalation charges. The rate to be charged under the contract, the origin and destination of the movement, and details of such special provisions are not considered essential terms and need not be disclosed. The reader of a rail rate contract would therefore not be able to discern the rate which is to be charged under the contract. Congress did not enact §10713(b) in order merely to protect the public's right to know that a particular railroad is hauling gravel somewhere in Texas under contract. The obvious purpose of §10713(b) is to provide information which will enable other railroads and shippers to compete. An example of the information provided to the public under the ICC's interpretation is contained in Appendix A, Contract Summary.

The Railroad Commission has raised this issue in both the Second and Fifth Circuit Courts of Appeal. Water Transport Assoc. v. I.C.C. & U.S.A., No. 82-4182 (Second Circuit of Appeals); State of Texas v. United States of America and Interstate Commerce Commission, No. 83-4318 (Fifth Circuit Court of Appeals). A detailed analysis of this issue is contained in Appendix B, Analysis of ICC Interpretations of Contract Disclosure Requirements Under 49 U.S.C. §10713(a).

III. MAXIMUM RATE GUIDELINES

Nearly three years after passage of the Staggers Act, the ICC has still not explained what, if any, level of rates would be considered unreasonable or excessive. Approximately one dozen state decisions have been overturned on grounds that the standard applied by the state was not consistent with federal standards. What standard should have been applied by the states is one of the best kept secrets in Washington.

The ICC has proposed guidelines for determining whether coal rates exceed a reasonable maximum. One of the four upward "constraints" on rail carriers' pricing on market dominant coal traffic as articulated in Ex Parte No. 347 (Sub No. 1) is "stand alone cost," or "that level at which the shipper could provide the service itself." No reasonable shipper, even in the absence of regulation, would pay more in the long run than the cost of providing the service itself. A second "constraint" would allow net rate of increases of 206% plus inflation over an eight year period. The guidelines, set forth in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines (decided February 8, 1983), could if adopted, be extended to other commodities as well. These guidelines make a mockery of Congress' assurance that captive shippers would be protected from exhorbitant rate increases. The vulnerability of captive shippers is explained in more detail in Appendix C, Analysis of Maximum Rate Guidelines.

IV. STATE CERTIFICATION

Congress provided that a state must receive ICC certification in order to continue regulating intrastate rail rates. In order to receive certification from the ICC, a state must agree to exercise its decision-making powers in accordance with provisions of the Staggers Act. Congress specifically directed the ICC to act on state request for certification in 90 days.

Some 40-odd states, including Texas, have given this assurance and requested certificated. The ICC has failed to comply with the statute. Three years later, the ICC has yet to unconditionally certify a single state. Instead, the ICC has continued to up the ante and now asserts that states must agree to follow all rules and practices of the ICC as a pre-condition to certification, thereby relegating states to the level of ICC staff. See Ex Parte No. 388, State Intrastate Rail Rate Authority--P.L. 96-448 (served February 8, 1982).

CONCLUSION

Congress should make the ICC accountable for its administration of the Staggers Act.

Congress declared as its purpose in enacting the Staggers Act the accomplishment of several objectives. One objective was to secure adequate revenues for the nation's railroads. Other specific policy objectives expressed in §10101(a) include the promotion of competition and the protection of captive shippers. An implicit objective in §214 of the Act was to preserve a meaningful role for the states in regulation of intrastate rail rates.

The ICC has, in its administration of the Act, emphasized the need for adequate rail revenues to the exclusion of all other objectives.

Congress should clearly enunciate the standard for judicial review of ICC decisions. Under the current provisions of the Staggers Act, the ICC is accountable to no one (other than Congress itself) for its perversion of the statute. Generally, administrative agencies are accountable in court for their administration of a statute. However, the ICC is effectively insulated from judicial review by the absence of any clear standard for judicial review. Absent any standard to which it can be held accountable, the ICC has over-ridden every state decision with which it disagrees.

In addition, the ICC should be limited, in its review of state agency decisions, so as to preserve to the state the kind of meaningful participation intended for them by Congress. The ICC should be permitted to override a state decision only where:

1. the state decision is contrary to the weight of the evidence;
2. the state decision is contrary to an express provision of the federal statute; or
3. the state decision has no rational basis in the National Transportation Policy, viewed as a whole.

If the ICC is to be permitted to pick and choose which parts of the National Transportation Policy it will implement, and the states are permitted only such role as pleases the ICC, Congress would do well to end the charade and pre-empt the states altogether so as not to deceive the public.

Congress needs to further clarify the area of discretion allotted to the states. States should be required to comply with the statute, and not the ICC's interpretation of the statute. States must further the National Policy, as set forth in 49 U.S.C. §11501(c) and not as butchered by the ICC. The ICC has consistently contravened the intent of Congress. Only by Congressional action can the ICC be brought into line with the intent of Congress.

We hope these comments prove useful to Congress as it analyzes the administration of the Staggers Rail Act of 1980.

APPENDIX A

Contract Summary

RAILROAD COMMISSION OF TEXAS

ICC/RCT MKT C-0096-B

MISSOURI-KANSAS-TEXAS RAILROAD COMPANY

CONTRACT SUMMARY

ISSUED: October 4, 1983

EFFECTIVE: October 5, 1983
(Subject to 49 CFR 1039.2)

ISSUED BY

T. F. Steiniger
Vice President-Marketing
MISSOURI-KANSAS-TEXAS RAILROAD COMPANY
420 Gimblin Road
St. Louis, MO 63147

R. R. C. OF TEXAS
OCT 5 1983
TRANS. DIVISION
AUSTIN, TEXAS

MISSOURI-KANSAS-TEXAS RAILROAD COMPANY

CONTRACT SUMMARY
ICC/RCT MKT C-0096-B

1.	PARTICIPATING CARRIER:	Missouri-Kansas-Texas Railroad Company 101 East Main Street Denison, TX 75020
2.	COMMODITY:	Crushed Stone
3.	a. ORIGIN:	Not Applicable
	b. DESTINATION:	Not Applicable
4.	DURATION OF CONTRACT:	One year, effective October 5, 1983, subject to the conditions of 49 CFR 1039.2.
5.	RAIL CAR DATA:	No cars dedicated to this service. MKT certifies that the equipment used under this Contract Tariff does not exceed forty percent (40%) of MKT owned or leased cars. MKT also certifies that equipment used does not exceed forty percent (40%) of MKT owned or leased cars used on the average by shipper, party to this Contract, during the previous three (3) years.
6.	RATES AND CHARGES:	Not Applicable
7.	SPECIAL FEATURES:	Not Applicable

APPENDIX B

Analysis of ICC Interpretations of Contract Disclosure Requirements Under 49 U.S.C. §10713(a)

RAILROAD COMMISSION OF TEXAS

ANALYSIS OF ICC INTERPRETATIONS OF CONTRACT DISCLOSURE REQUIREMENTS UNDER 49 U.S.C. §10713(a)

I. CHARACTERIZATION OF THE ISSUE

49 U.S.C. §10713(a), enacted as part of the Staggers Rail Act of 1980, expressly authorizes rail carriers and shippers to enter into contracts specifying the terms under which rail transportation services will be provided. Section 10713(b) requires that a tariff, containing all essential terms of the contract, be made available to the general public.

A tariff, by definition, is a document by which the public is apprised of rates and related provisions applicable to regulated transportation.

Nevertheless, the Interstate Commerce Commission (ICC) determined in Ex Parte No. 387, *Railroad Transportation Contracts*, that the tariff required under §10713, unlike all other tariff publications required by federal law, need not divulge the level of rates to be paid under the related contract.

Congress did not intend, in enacting §10713, to authorize this radical departure from prior practice.

II. ARGUMENT AND AUTHORITIES

A. Prior Usage Of The Term "Tariff" Has Consistently Been To Require That The Level Of Rates To Be Changed Be Disclosed To The Public.

Corpus Juris Secondum defines the term "tariff" as follows:

> "As ordinarily understood, a system of rates and charges;...a book of rates..."

83 C.J.S. p. 943. Substantially the same definition is given in Black's Law Dictionary.

The term "tariff," as used in the context of rail transportation, means, likewise denotes a document setting forth the rates to be charged for service to which the tariff applies. The Eighth Circuit Court of Appeals, in Union Wire Rope Corporation v. Atchison, Topeka and Santa Fe Railway Co., held that a tariff is, in essence:

> "...a statement by the carrier to possible shippers that it will furnish certain services under certain conditions for a certain price."

66 F.2d 965, 966 (8th Cir., 1933).

"Tariff" has been construed to mean a document setting forth applicable rates in other contexts as well. See United States of

America v. Associated Air Transport, Inc., 275 F.2d 827, 833 (5th Cir., 1960).

The foregoing usage is codified as part of the Interstate Commerce Act of 49 U.S. Code §10762. §10762(c) provides that:

> "A carrier providing transportation or service subject to the jurisdiction of the Interstate Commerce Commission under Chapter 105 of this title (except a motor common carrier) shall publish and file with the Commission tariffs containing the rates and (A) if a common carrier, the classifications, rules and practices relating to those rates...A motor common carrier shall publish and file with the Commission tariffs containing the rates for transportation it may provide under this subtitle."

(emphasis added) The provisions of §10762(a) apply to rail carriers, motor common carriers of property, and motor common carriers of passengers. Section 10762 and its antecedents were "the source of all tariff publication and filing requirements" applicable to such carriers prior to enactment of the Staggers Rail Act of 1980. Aberdeen and Rockfish Railway Co. v. United States, 682 F.2d 1092 (5th Cir., 1982).

B. The rules adopted by the ICC under Ex Parte No. 387, Railroad Transportation Contracts, are contrary to the provisions of §10713 which incorporates prior usage of the term "Tariff."

The text of the Staggers Rail Act of 1980, as well as its legislative history, shows clearly that Congress intended the level of rates applicable under a rail transportation contract to be included in a tariff available to the general public.

The phrase essential terms of the Contract is unambiguous, especially in light of consistent prior usage. However, any ambiguity would easily be resolved by reference to the legislative history which is explicit. The phrase "essential terms of the contract" originated in the Senate Bill. The Senate Report states that:

> "At a minimum, however, the essential terms of the contract should be filed, including but not necessarily limited to the rates, commodities, origin and destination, and the parties of the contract."

S. Rep. No. 470, 96th Congress, 1st Session, 35-36 (1979) (emphasis added) The legislative history, in both the House and the Senate, is entirely devoid of any statement which supports the ICC's central theme that Congressional concern for the confidentiality of contract terms overrides all other considerations.

The ICC, in its decision in Ex Parte No. 387, Railroad Transportation Contracts, requires that the base rate be disclosed in a tariff accompanying the contract, but does not require that discount, volume allowance, escalation, or other provisions which would cause the rate paid for transportation service to differ from the base rate, be revealed. For example, the public could be advised in the tariff that a base rate of $500 per car is applicable under the contract, while, unbeknownst to them, the rate actually paid may range from $250 per car to $750 per car due to undisclosed discount or escalation provisions.

C. Failure to Require that Rates to be Charged Under a Rail Transportation Contract Be Included in the Published Tariff Defeats the Primary Purpose of Requiring that a Tariff be Published.

The underlying rationale for requiring that a tariff be published is succinctly described by the Seventh Circuit Court of Appeals in Western Transportation Company v. Wilson and Company, Inc.

> "Congress was concerned with-at least ostensibly, and ostensible concerns are pretty must all a court can consider when, constructing a statute-was the 'evil' of the big shippers' getting secret 1st Sess. 181, 188-90, 198-200 (1886); New Haven R.C. v. L.ED. 515 (1906). To prevent this supposed evil Congress required the railroads (and later the motor carriers, when they were brought under the Interstate Commerce Commission's wing too) to charge only in accordance with published tariffs. Sec Act of Feb. 4, 1887, ch. 104, § 6(7), 24 Stat. 380, as amended, 49 U.S.C. §§10761, 10762...This goal would be subverted if a shipper of carrier could be agreement change the terms of the applicable published tariff. See S. Rep. N. 46, supra, at 200."

682 F.2d 1227, 1230-1231 (7th Cir., 1982)

CONCLUSION

The ICC has, in its decision in Ex Parte 387, Railroad Transportation Contracts, departed from all prior usage of the term "tariff," including its own construction of the term at the time the Staggers Act was under consideration by Congress. While a consistent and longstanding construction of a statute by the agency entrusted with its administration is entitled to some deference. An agency interpretation which radically departs from prior usage is entitled to little or no deference. Bayside Enterprises, Inc. v. NLRB, 429 U.S. 298, 303, 97 S.Ct. 576, 580, 50 L.Ed.2d 494 (1977). A careful analysis of the statute and its legislative history shows, moreover, that the decision of the ICC in Ex Parte No. 387 is contrary to Congressional intent embodied in 49 U.S. Code §10713.

APPENDIX C

Analysis of Maximum Rate Guidelines

RAILROAD COMMISSION OF TEXAS

A. INTRODUCTION

In Ex Parte No. 347 (Sub-No. 1) Coal Rate Guidelines, Nationwide (decided February 8, 1983) (hereinafter X347/Sub-1, or Decision) the Interstate Commerce Commission (ICC) proposed a maximum rail rate policy applicable to captive coal traffic.

Under the "Constrained Market Pricing" approach proposed in X347/Sub-1, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the "stand-alone" cost of serving its traffic. Second, captive shippers would not be required to bear the cost of "obvious management inefficiencies." Third, carriers would generally not be permitted to increase their rates on captive coal traffic by more than 15% in a single year after allowing for inflation. Fourth, until a rail carrier achieved revenue adequacy, it would be free to adjust its rates unless it violates one of the three constraints previously listed. If a rate on market dominant coal traffic violates any one of these constraints, it may be found to be unreasonably high.

The Railroad Commission of Texas (RCT) respectfully submits that the "Constrained Market Pricing" approach proposed under X347/Sub-1 is contrary to the provisions of the Staggers Rail Act of 1980 as incorporated into the Interstate Commerce Act (Act).

B. ANALYSIS OF PERTINENT STATUTORY PROVISIONS

It is abundantly clear, from both the text of the Staggers Act and its legislative history, that captive shippers were to be protected from excessive rate increases. Forty-nine U.S. Code §10101a declares it to be the policy of the United States government:

> [T]o maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital....

Forty-nine U.S. Code §10701a provides that:

> If the Commission determines...that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable.

Both the Senate and House Reports make clear that, while greater pricing flexibility is allowed under the new law, captive shippers are still to be protected and that concern for adequacy of rail revenues may not override concern for the plight of captive shippers. The Senate Report states, at page 5, that:

> At the same time, the Committee wishes to make it crystal clear that the adequate revenue level provisions are not to be construed in a manner which ignores other important considerations of this title and 49 U.S.C. This bill provides continued protection for shippers where such protection is necessary in the public interest. The Committee expects this protection to be utilized by the Commission to prevent extensive cross-subsidization or an excessive contribution from captive traffic.

S. Rep. No. 470, 96th Cong., 1st Sess. 5 (1979). The Senate Committee's concern is nowhere greater than in setting maximum rates for coal shipments:

> The rates on coal are of particular concern in view of the many substantial increases imposed on this traffic in the last several years.

Id. The House Report and Conference Reports likewise stress that the revised statute was designed to achieve a balance between the need for protection of captive shippers and the railroads' need for adequate revenues.

C. ANALYSIS OF CONSTRAINED MARKET PRICING

The four elements of "Constrained Market Pricing" provide little or no protection for captive shippers.

1. Stand-Alone Cost

The first criterion for evaluating the reasonableness of a maximum coal rate under the Constrained Market Pricing approach is "stand-alone cost" which "represents that level at which the shipper could provide the service itself." Decision at 6. The ICC concludes that:

> No shipper would reasonably agree to pay more to a railroad for transportation than it would cost to produce in isolation itself, or more than it would cost a competitor of the railroad to provide the service to it.

Id. Stand-alone cost is proposed as a surrogate for competition, and the point at which cross-subsidy would begin.

It is not surprising that both carriers and shippers agree that stand-alone cost represents the absolute maximum rate that can be assessed. No reasonable shipper, even in the absence of regulation, would pay more in the long-run than the cost of providing the service itself. Only short-run monopoly power, deriving from lag time in construction and acquisition of alternative transportation facilities and equipment, would allow a railroad to exact more than stand-alone cost. In describing the industry cost structure, the Decision recited that the rail industry has a very high initial investment requirement. It also found that many rail costs are not directly attributable to particular services. These are described as joint or common costs. Most importantly, the ICC declared that railroads exhibit significant economies of scope and density. Id. at p. 5.

Use of stand-alone cost as a rate ceiling effectively deprives coal shippers of the benefits of spreading joint costs, as well as economies of scope and density, which the ICC earlier found to be characteristic of the rail industry. High initial investment is the chief factor which makes regulation necessary.

The conclusion that the cross-subsidization and excess contributions with which Congress was concerned begins at the level of stand-alone cost is erroneous. Congress promised some measure of protection for captive shippers and devoted a substantial portion of the Staggers Act to insuring that some measure of protection would be provided. Since, at rates above stand-alone cost, a rational shipper would provide the service itself rather than pay a railroad for service, a stand-alone cost standard for maximum coal rates fails to fulfill the statutory mandate. Since shippers will not likely pay a rate above stand-alone cost, no matter what protection is or is not afforded by the statute, the Decision ascribes to Congress the fraudulent intent to provide an ineffective solution to a purely theoretical problem.

Presumably this "standard" is intended to encourage other modes of transportation. However, captive shippers, by definition, are effectively tied to rail transport. Allowing rates to reach a level where a captive shipper could as economically construct his own railroad is premised on an inefficient allocation of resources.

Even accepting arguendo that it is reasonable for a shipper to invest in a rail system, in the long run this pricing, if played to conclusion, will encourage shippers to invest in alternate modes of transportation thus decreasing the existing railroads' traffic. Furthermore, because of the high fixed costs, shippers that invest in rail facilities will be encouraged to solicit other traffic. The result could be ruinous competition detrimental to all carriers.

The perception of many utility executives, as noted in Appendix B of the Decision, is that railroads will maximize short-term gains rather than pursue long-term pricing policies. This "ceiling" of stand-alone cost will not protect a customer from a railroad which makes a corporate decision to maximize short-term gains to facilitate corporate goals such as immediate diversification. The stand-alone cost standard satisfies neither the statutory requirement of 49 U.S. Code §10701a that rates to captive shippers must be reasonable, nor the intent of the Congress, evident in portions of the legislative history cited above, to prevent extensive cross-subsidization or an excessive contribution from captive traffic.

2. Obvious Management Inefficiencies

The second tenet of the Constrained Market Pricing approach is that the captive shippers will not be required to bear the cost of "obvious management inefficiencies." In §§10704(a)(2) and 10701a(b)(3) of the Act, the Commission is instructed to "maintain and revise as necessary standards and procedures for establishing revenue levels for rail carriers...that are adequate, under honest, economical, and efficient management...." Additionally, Congress provided in section 203 of the Staggers Act (49 U.S. Code §10707a) that several factors must be considered in determining the reasonableness of particular rail rates. These factors, contained in an amendment proposed by Senators Long and Cannon, are referred to as the "Long-Cannon factors."

The ICC gave the following description of the Long-Cannon factors at X347/Sub-1, p. 7:

> Briefly, in deciding whether to investigate a proposed rate increase, we must consider: (1) the amount of the carrier's traffic that fails to contribute to going concern value and the carrier's efforts to minimize such traffic; (2) the amount of traffic that contributes only marginally to fixed costs and the extent to which rates on such traffic can be raised; and (3) the impact of the proposed rate increase on national energy and the rail transportation policy. 49 U.S.C. 10707a(e)(2)(B). In judging rate reasonableness, we must consider the first two factors listed above and a third factor--the carrier's mix of rail traffic to determine whether one commodity is paying a unreasonable share of the carrier's overall revenues. 49 U.S.C. 10707a(e)(2)(C).

The concerns underlying the Long-Cannon factors are characterized in X347/Sub-1 as considerations of "management efficiency." The reader is referred to Docket No. 38754, Arkansas Power and Light Co., et al., Petition to Institute Rulemaking-Implementation of the Long-Cannon Amendment to the Staggers Act, 365 ICC 983 (1982), for guidance in determining how "obvious management inefficiencies" will be identified.

In Arkansas Power and Light Co., supra, the "honest, economical, and efficient management" provisions of §§10704(a)(2) and 10701a(b)(3) were discussed as were the concepts of "going concern value" and "variable cost" contained in §10701a(c). Two prior decisions were cited for the proposition that a rate which equals or exceeds "direct variable cost" (DVC) would not be found to be unreasonably low. Cost Standards for Railroad Rates, 364 ICC 898 (1981), affirmed, Water Transport Association v. ICC, 684

F.2d 81 (D. C. Cir., July 27, 1982). Later in the opinion, the Commission discussed how evidence relating to the Long-Cannon factors should be introduced. The ICC did not, however, explain in Arkansas Power and Light Co., or in X347/Sub-1, what substantive standards would be used to evaluate evidence relating to the Long-Cannon factors, nor was any explanation given concerning the circumstances under which carrier management would be considered dishonest, uneconomical, or inefficient. It appears the ICC believes the requirements of "honest, economical and efficient management" and the Long-Cannon factors are one and the same.

The RCT submits that the requisites of §10704(a)(2) and the Long-Cannon factors of §10707a(e)(2)(C) require separate and distinct determinations. Section 10704(a)(2) speaks of "revenue levels" for rail carriers. Section 10707a(e)(2)(C) requires the Commission to utilize the Long-Cannon factors "[i]n determining whether a rate is reasonable..." [Emphasis added].

"Honest, economical, and efficient management" may be a useful concept in setting an overall revenue adequacy target. However, it is difficult to conceive any fruitful inquiry which can be made into a carrier's honesty or efficiency in the context of a particular rate as required by the Long-Cannon factors. The evidentiary and other obstacles to such an inquiry would be tremendous.

Furthermore, there was no explanation given concerning the relationship between standards of minimum rate reasonableness in §10701a(c) and the determination of whether a particular shipper or group of shippers is paying an unreasonable share of the carrier's overall revenues as required by the Long-Cannon Amendment. If it is the position of the ICC that unless a significant portion of a carrier's traffic is being carried at rates below DVC, a captive shipper's contribution to total revenues is not unreasonable, the RCT would respectfully disagree. The Long-Cannon Amendment requires consideration not only of the amount of traffic which fails to contribute to the going concern value but also of the traffic which contributes only marginally to fixed costs. Moreover, whether a particular shipper or group of shippers is paying an unreasonable share of the carrier's total revenues is a consideration separate and distinct from whether substantial portions of the carrier's traffic contribute minimally, or not at all, to going concern value. For example, it does not follow under the statute that a rate 200 points above fully allocated cost could reasonably be imposed on a captive shipper representing 5% of the carrier's traffic simply because 50% of the carrier's traffic was being handled at rates which, although exceeding DVC, were twenty points below fully allocated cost.

Because of the burden placed upon a complainant in relation to the Long-Cannon factors, the ICC declared it will grant reasonable discovery requests. The Act imposes short deadlines for deciding rate cases. A complainant will be placed at a severe disadvantage in attempting to complete discovery on a carrier's traffic prior to hearing. This is particularly so because at the pre-hearing stage of the proceeding a complainant could not know what substantive standards the ICC intends to use in assessing the Long-Cannon criteria.

In summary, the central flaw in this facet of Constrained Market Pricing is that the specific requirements of the Long-Cannon factors cannot be discharged through some broad assessment of "management efficiency." Extraction of maximum revenues from captive shippers may be efficient from the standpoint of the railroad. From the standpoint of national policy as incorporated into Interstate Commerce Act, such extractions may nevertheless be unreasonable. Moreover, one commodity may be paying an unreasonable share of the carrier's overall revenues, even where the railroad is not carrying a substantial amount of its traffic at a loss or at suboptimal rates. So long as the ICC analyzes the issue addressed by the Long-Cannon factors as one of "management efficiency" rather than one of legislative policy toward captive shippers, this aspect of Constrained Market Pricing will provide little or no protection to shippers since such subjective considerations are seldom susceptible to proof.

3. *Revenue Adequacy*

The third tenet of Constrained Market Pricing is that, "if the other constraints. . . are in force, the rate that a carrier charges its captive customers is not unreasonably high when the carrier's overall revenues are less than the adequacy level." The revenue adequacy level, as defined in Ex. Parte No. 393, *Standards for Railroad Adequacy* (March 30, 1981), is the level at which rail revenues provide a rate of return on net investment equal to the current cost of capital. A railroad would not, under the Constrained Market Pricing approach, be considered revenue adequate until it had achieved a rate of return on net investment equal to the current cost of capital consistently over a number of years. The decision stated that:

> Our definition of revenue adequacy in this context requires a long run, rather than short run, perspective,...[c]onsequently, we do not intend to require the railroads to continuously adjust rates on captive traffic so as to maintain perfect year-to-year conformance with the prescribed revenue adequacy level....However, where a *consistent pattern* of returns *substantially in excess* of carrier's revenue needs has been established, we would, *upon complaint*, consider the reasonableness of rates on captive coal traffic and prescribe lower rates *in appropriate circumstances*.

Decision at 8 [Emphasis added].

The RCT submits that this standard provides little, if any, of the protection Congress intended to provide for captive shippers. To begin with, the elements of the standard ("consistent pattern" and "substantially in excess of...revenue needs") are sufficiently vague and subjective so as to provide no real guidance to captive shippers or others. Further, such a standard would, in practice, provide no meaningful protection for captive shippers. According to one study cited by the ICC, Decision at 9, it would take a minimum of eight years, even under the Constrained Market Pricing approach, for the nation's coal-hauling railroads to achieve revenue adequacy. Add to this the number of years required to demonstrate a "consistent pattern of returns of substantially in excess of...revenue needs," and it is apparent that, for the foreseeable future, revenue adequacy will not constitute a meaningful restraint on coal rate increases. Moreover, the ICC projects, based on the studies contained in Appendices B and C to the Decision, discussed below, that within three to eight years new transportation alternatives will be available to shippers presently captive to the railroads. If this is the case, the approach to revenue adequacy proposed in X347/Sub-1 would permit the railroads unrestrained freedom to exact contributions from captive coal shippers until the time that they are no longer captive. Coal shippers would therefore be stripped of the protection of which, it is evident from the Staggers Act and its legislative history, it was Congress' intent to provide.

4. Phased in Rate Increases (15% per year)

The final tenet of Constrained Market Pricing is that a railroad may not raise coal rates more than 15% per year. This tenet, which is the only aspect of Constrained Market Pricing which would act as a real constraint on coal rates, is a blatant rewrite of the statute.

Forty-nine U.S. Code §10707a allows annual percentage increases in rail rates. The limit on sudden increases is 6% during the first four years and 4% thereafter. The Conference Committee Report makes it clear that even these increases are not presumptively reasonable. The report states that:

> The reasonableness of such rate increases shall be determined under the same standards of maximum reasonableness applicable to any other rate or rate increase.

Conference Report, H.R. Rep. No. 1430, 96th Cong., 2d Sess. 11 (1980). This "zone of rate flexibility" under §10707a is available regardless of whether or not a shipper is captive.

The proposed rule would expand the zone of rate flexibility from 4% to 15% with respect to the group of captive shippers for which Congress has expressed the most concern. Increases not exceeding 15% under the Constrained Market Pricing approach, would be presumed reasonable, unlike even the 4-6% increase contemplated by the Staggers Act. This proposal is contrary to express provisions of the Act.

Furthermore, this tenet would not actually limit rate increases to 15% per year. The 15% zone does not include any increase which represents "merely pass through of the effects of inflation." Decision at n. 46. The maximum increase would therefore be 15% plus inflation adjustments. Moreover, the 15% figure would be cumulative so that an increase could be deferred and taken in a another year along with that year's allotted increase. Id. For example, a carrier could raise its rates 5% plus inflation during one year and 25% plus inflation the next. The ICC would retain discretion to permit an even greater increase where appropriate. Id.

The rationale given for allowing "phased-in" increases of 15% per year is not persuasive.

First, the the 15% limitation would purportedly moderate the inflationary impact of rail rates on coal traffic as well as the dislocations which could result from sudden dramatic increases in coal transportation rates.

The RCT respectfully submits that the proposed standard would not have the effect ascribed to it. There is nothing moderate in a rate increase of 15% per year plus inflation. The decision states that this increase factor would allow most of the national coal hauling railroads to achieve revenue adequacy within eight years. Decision at 9. A 15% per year increase over eight years results in a net increase of 206% plus inflation over the eight year period. Increases of this magnitude can hardly be described as non-inflationary.

Second, the 15% limitation would allegedly create or mandate incentives for carriers to optimize existing rate structures and facilities so that all traffic segments make their maximum contribution to the carriers' revenues. "We reiterate that our market pricing proposal requires this contribution to overhead cost by competitive traffic to the greatest extent possible." Id.

Exactly how allowing railroads to exact increases of 15% annually from captive coal shippers would encourage railroads to rationalize their rate structures is not explained. Railroads assess rates on captive traffic in excess of fully allocated cost in order to offset inadequate contributions to fixed and capital costs made by competitive traffic. A proposal to allow such generous increases on captive coal traffic is calculated to encourage, rather than discourage, price cutting on competitive traffic to lure shippers away from alternative transportation, even where the traffic might more efficiently be handled by other modes. The proposal to allow each carrier a 15% increase per year is therefore arbitrary in that it bears no relation to the individual carrier's rate structure.

Third, it is asserted, the phasing-in of increases at a rate of 15% per year will afford captive shippers time to evaluate transportation alternatives for the future. The ICC concludes that many captive coal shippers could have other transportation alternatives within three to seven years. Id. The ICC bases its conclusion on two studies which it interprets to state that current market constraints can be expected to diminish because of several factors: the expiration of existing coal purchase contracts, entry by new modes of transportation including coal slurry pipe lines, the retirement of old utility plants and construction of new plants at locations that are less dependent upon an single carrier or transportation mode, power interchange among utilities, and installation of scrubbers that will allow the burning of higher sulfur coal.

The RCT submits that the conclusion that transportation alternatives will be available in the near future is not supported by the studies.

The first study, entitled Analysis of Source or Geographic Competition for the Delivery of Steam Coal to Utilities, Appendix B, was prepared by DNS Associates, Inc. (DNS). DNS prefaced its remarks with the caveat that the study does not address the reasonableness of rail rates or equity in allocation of resources, since those issues were beyond the scope of the study. DNS did, however, make several pertinent findings:

1. Of the utilities surveyed, 53% are constrained from effectively using geographic or source competition to some degree.
2. Many utility executives reported concern with the stability as well as the level of rail rates. Some executives perceived railroads as maximizing short term gains rather than pursuing long term pricing policies.
3. Delivery by truck or barge without rail involvement generally assured freedom of entry for competing carriers and thereby provided the utility with significant control of transport costs.
4. The Environmental Protection Agency and related state regulations are regarded as the most significant constraints on future planning of utility plant construction and coal usage.
5. Issues of acid rain and unsettled emission standards are a major source of uncertainty in the utility planning process.

6. As reported by many utility executives, it is now more cost-effective to switch to low-sulfur fuel rather than to install scrubbers.

The report concludes that public utilities will experience little improvement in access to coal source competition through 1985; Beyond 1985, the market strength of utilities should increase due to greater access to source competition resulting in stronger negotiating positions.

The optimistic, "best case" scenario adopted as the basis for the Decision in X347/Sub-1 is unrealistic and is generalized. The sweeping language of the Decision makes no provision for the unique circumstances of receivers such as Texas utilities which do not have feasible truck or barge transportation available and are dependent upon rail transportation of low-sulfur coal. Nowhere does the study conclude that utilities such as those in Texas are likely to have more transportation alternatives available within three to seven years, particularly since environmental considerations were found to be "uncertain" at this time but were declared by DNS to be "the most significant constraint on future planning of utility plant construction and coal usage." Perhaps some utilities will be better positioned in three to seven years, but the DNS report provides insufficient support for a national policy decision predicated on availability of non-rail alternatives in the foreseeable future.

The second study, Competitive Impact of Coal Slurry Pipelines on the Transportation of Coal, Appendix C, was prepared by

Consulting Center Associates, Inc. (CSA). This study declares at the outset that it is based on the assumption that federal eminent domain power will be granted to coal slurry pipelines. As of this writing, that power has not been conferred on coal slurry pipelines. Even if federal eminent domain power is granted, the report confirms that conflicts over water rights will remain a severe problem. The report then notes that a competitive threat from coal slurry pipelines, "is not envisioned as becoming ubiquitous throughout the nation." These factors lead the writers to a bad news--good news conclusion:

> All of these restraints impute that coal slurry pipelines would not replace rail transportation of coal. However, the possibility of their existence arises if railroad pricing practices result in increases one-third greater than those prevailing today.

This analysis is intriguing considering a subsequent disclaimer in the report that, "Our conclusions do not address whether or not slurry pipelines are truly cost-competitive with rail transportation." In other words, the study accounts for physical and engineering obstacles to coal slurry pipelines, but not for economic obstacles. Furthermore, increased rates will create a realistic possibility of coal slurry pipelines only in geographically select portions of the nation. The report states that of the ten slurry pipeline systems currently being planned, four are considered likely to be constructed within the next ten years. The other six are expected to encounter market problems and problems obtaining legal access to water which seriously endanger their chances of being built. None of the four likely candidates would serve Texas.

The CSA report only emphasizes the speculative and isolated nature of the competitive threat from coal slurry pipelines. Again, neither report supports the conclusion that transportation alternatives will be available in three to eight years.

The RCT submits that the proposal to allow phased-in increases of 15% per year is not supported by the Decision and is contrary to provisions of the Interstate Commerce Act.

D. SUMMARY OF COMMENTS

The Constrained Market Pricing approach is inconsistent with provisions of the Staggers Rail Act of 1980 as incorporated into the Interstate Commerce Act. None of the proposed standards are sufficiently supported by the Decision or provide the level of protection to captive shippers which they are entitled to under the statute. The RCT submits that the ICC is not authorized, by rulemaking or otherwise, to adopt or apply Constrained Market Pricing as a guideline in determining the reasonableness of maximum coal rates.